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In the Supreme Court of the United States

OCTOBER TERM, 1972

~~72-442~~

J. J. LOWENTHAL, ET AL., A CLASS OF INTERVENING DEFENDANTS,

Petitioners,

vs.

ALEXANDER TCHEREPNIN, ET AL., AND THE CLASS FOR WHOM THEY ARE THE NAMED PLAINTIFFS,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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J. J. LOWENTHAL, ET AL., A CLASS OF INTERVENING DEFENDANTS,

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ALEXANDER TCHEREPNIN, ET AL., AND THE CLASS FOR WHOM THEY ARE THE NAMED PLAINTIFFS,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

The Petitioners pray that a Writ of Certiorari issue to the United States Court of Appeals for the Seventh Circuit to review the judgment of that Court entered on May 15, 1972, which affirmed with modification an order for the District Court for the Northern District of Illinois, authorizing rescission for fraud, by the Respondent Plaintiffs Class of depositor shareholders and provided for a preference to this Class of depositor shareholders over all

other creditors, thereby, in effect, depriving approximately 5,000 depositor shareholders, not in the Plaintiffs' Class, and who by order of the District Court compose the Class of Petitioners herein, from any participation in the liquidated assets of the State of Illinois organized and chartered savings and loan association, to wit, the City Savings Association of Chicago, Illinois.

OPINIONS BELOW

The opinion of the United States District Court has not been reported and is printed in the Appendix herein at Page App. 28.

The opinion of the United States Court of Appeals for the Seventh Circuit presented for review is not yet reported, but is printed in the Appendix herein at Page App. 1.

JURISDICTION

This case was argued November 1, 1971, and the judgment of the Court of Appeals was entered on May 15, 1972 (App. 22).[1] (Senior Judge Earl Major heard the argument but did not participate in the opinion or judgment.)

A timely Petition for Rehearing was filed in the Court of Appeals for the Seventh Circuit by the Petitioners and was denied on June 20, 1972. This Petition for Certiorari is filed within 90 days of the denial of the Petition for Rehearing. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254(1).

---

[1] "(App. .....)" is hereinafter used to refer to pages of the Appendix to this Petition.

QUESTIONS PRESENTED

1. May a District Court dispense with a trial affording due process including the right of confrontation of witnesses and presentation of evidence on the issue involved, and by judgment and decree deprive 5,000 defrauded depositor shareholders of a savings and loan association of their right to participation in the liquidated assets in the savings and loan association?

2. May a District Court dispense with the constitutional requirement of a trial on contested issues and enter a final judgment and decree which deprives thousands of depositor shareholders of property consisting of liquidated assets of a savings and loan association under the purported authority of Section 1407, Title 28 U.S.C. and the "Manual for Complex and Multi-District Litigation" adopted under its provisions and providing for consolidation of multi-district litigation, or any other authority?

3. Did the Courts below err in determining that only one part of the total class of all defrauded depositor shareholders was entitled to share in the liquidated assets of City Savings Association?

4. Does not the decision preferring part of all of the defrauded shareholders distort the intent of the Securities Exchange Act and its Regulation 10-b-5?

5. Did the Courts below err in failing to find that the pre-July 9, 1959 depositors who exchanged accounts after July 9, 1959 and signed new perpetual proxies, did consummate a "purchase or sale" of a security, and thus should be treated as part of the preferred post-July 9, 1959 class of depositor shareholders?

6. Where depositor shareholders of a savings and loan association consist of persons who deposited and thus ac-

quired shares both before and after July 9, 1959, did not all those depositor-shareholders who were fraudulently induced to deposit money or to exchange accounts, concurrent with the execution of blind perpetual proxies which enabled the execution of fraud by the officers and directors of the institution, or who were fraudulently permitted to withdraw small amounts of their deposits, thereby reducing their purported shareholdings, come within the purview of the Security Exchange Act of 1934 and its Regulation 10b-5 proscribing fraud in the "purchase or sale" of a security?

7. Where it is uncontradicted that a purported class of depositor shareholders in a savings and loan association received "valuable premiums" in inducement and consideration for their deposits and purchase of shareholder rights, is it not a condition precedent to rescission that they make or tender restitution of said "expensive premiums"?

CONSTITUTIONAL PROVISIONS, STATUTES, AND RULES INVOLVED

Amendment V, Constitution of the United States

> "No person shall . . . be deprived of life, liberty, or property, without due process of law; . . ."

Title 28, United States Code

> "§ 1407. Multidistrict litigation
>
> (a) When civil actions involving one or more common questions of fact are pending in different districts, such actions may be transferred to any district for coordinated or consolidated pretrial proceedings. Such transfers shall be made by the judicial panel on multidistrict litigation authorized by this section upon its determination that transfers for such proceedings will be for the convenience of parties and wit-

nesses and will promote the just and efficient conduct of such actions. Each action so transferred shall be remanded by the panel at or before the conclusion of such pretrial proceedings to the district from which it was transferred unless it shall have been previously terminated: *Provided, however,* That the panel may separate any claim, cross-claim, counter-claim, or third-party claim and remand any of such claims before the remainder of the action is remanded.

• • •

Section 10(b) of the Securities Exchange Act of 1934 reads as follows (15 U. S. C. § 78j(b)):

"(10) It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

• • • • •

"(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Rule 10b-5 promulgated by the Securities and Exchange Commission under the Securities Exchange Act of 1934 reads as follows (17 CFR 240, 10b-5):

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange

(1) to employ any device, scheme, or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the

circumstances under which they were made, not misleading, or

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security."

Sections 3(a)(10), (13) and (14) of the Securities Exchange Act of 1934 read as follows (15 U. S. C., §§ 78c(a)(10), (13) and (14)):

"(3)(a) When used in this title, unless the context otherwise requires—

• • • • •

"(10) The term 'security' means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general any instrument commonly known as a 'security'; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subsribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited."

"(13) The terms 'buy' and 'purchase' each include any contract to buy, purchase, or otherwise acquire."

"(14) The terms 'sale' and 'sell' each include any contract to sell or otherwise dispose of."

STATEMENT OF THE CASE

The opinion and judgment of the Court of Appeals for the Seventh Circuit below affirmed, with modification, the order and judgment of Judge Campbell of the United States District Court for the Northern District of Illinois which established a preference to part of the depositor shareholders of the City Savings Association, a defunct savings and loan association chartered under the laws of the state of Illinois and doing business in the State of Illinois. There are more than 5,000 depositor shareholders in each of the classes arbitrarily determined to exist by the District Court. There is no question but that the members of both Court determined classes are the victims of fraud. As members of the public, all were solicited by advertisement and representations of supervision by the State of Illinois and membership of the City Savings Association in the Federal Home Loan Bank, to become depositors in the City Savings Association, prior to June 30, 1964.

Subsequently, this Court in *Tcherepnin, et al* v. *Knight, et al*, 389 U.S. 332, 19 L.Ed. 2d 564 (1967), determined for the first time that depositors in savings and loan associations such as City Savings Association, were in fact security purchasers, subject to the Securities Exchange Act and regulations thereunder.

Pertinent History of City Savings Association.

City Savings Association was originally chartered by the State of Illinois on February 28, 1908 under a different name. In 1943, it adopted its present name.

On April 25, 1957 the Auditor of Public Accounts of the State of Illinois took custody of CSA and suspended payments to depositors.

Pursuant to a decree entered by the Circuit Court of Cook County, Illinois on December 6, 1957, custody of CSA

was restored to its officers and directors on December 14, 1957 by the Director of Financial Institutions of the State of Illinois. It was reopened to the public on December 19, 1957 [but on a limited withdrawal rotation basis as to its then existent accounts on which basis it continued until it closed in June, 1964.]

On February 3, 1959, the Circuit Court of Cook County entered a final decree adopting the findings and conclusions of the December 6, 1957 decree and terminating jurisdiction of the court over CSA, including the requirement of periodic reports to the court.

On January 22, 1960 the Supreme Court of Illinois affirmed the decree returning custody of CSA to its management (*Mensik* v. *Smith*, 18 Ill.2d 572, (1960)).

On June 26, 1964, the Director of Financial Institutions of the State of Illinois took custody of CSA pursuant to Section 7-8 of the Illinois Savings and Loan Act (S.H.A., Ch. 32, §848) (hereinafter "the Illinois Act") once again.

On June 30, 1964, CSA was closed by the Director of Financial Institutions.

From June 26, 1964 to September 11, 1964, CSA was in the custody of the State of Illinois, acting through the Director.

From September 11, 1964 to September 19, 1968, CSA was in the custody of three liquidators under a plan of voluntary liquidation purportedly adopted under Article 9-1 *et seq.* of the Illinois Act (S.H.A., Ch. 32, §901 *et seq.*).

On September 7, 1968, two federal receivers were appointed by the District Court. After denial of supersedeas by the Court of Appeals, they took custody of CSA on September 19, 1968, and have since managed the assets of CSA.

The Two Classes of CSA Depositors Involved in This Appeal.

Almost immediately after CSA's custody was restored to its officers and directors by the decree of the Circuit Court of Cook County entered on December 6, 1957, CSA, by resolution of its board of directors, imposed limitations on the amounts which its depositors could withdraw and placed them on a rotation system. (CSA minutes of December 14, 1957.) In so doing, CSA acted under the provisions of Section 4-13(b) of the Illinois Act (S.H.A., Ch. 32, §773(b), providing that "if the association has insufficient funds in the treasury and from current receipts to pay all matured accounts and applications for withdrawal, within thirty days after such accounts mature or payment is requested, then the board of directors shall provide by resolution" for the operation of the association on a restricted withdrawal and rotation basis.

On July 9, 1959, Section 4-13(h) (S.H.A., ch. 32, §773(h)) of the Illinois Act became effective until its repeal on July 23, 1965. It provided:

> "An association while operating under this section may accept additional withdrawable capital from its present shareholders as well as accept new withdrawable capital accounts and such withdrawable capital accounts shall not be subject to the provision of subsection (b) of this section but shall be subject to withdrawal at will so long as the association is operating under the provisions of subsection (b) of this section."

Shortly thereafter CSA established three new accounts: Investment Shares—Investment Plan; Investment Shares—Thrift Plan; and Christmas Club. Pursuant to Section 4-13(h), these accounts could not be subject to the restrictions of Section 4-13(b). Virtually all accounts opened by plaintiffs and their class were Investment Shares—Thrift Plan accounts.

Pursuant to Fed. Rules Civ. Proc. rule 23(c), 28 U.S.C.A., the District Court defined the classes here as (a) those who first opened accounts on or after July 9, 1959 (plaintiffs and their class) and (b) those who opened any account prior to that date (intervening defendants). (A. 46).

From the nature and number of complaints from depositor shareholders who first deposited prior to July 9, 1959, it is clear that there is a substantial number of these persons who deposited additional money in the City Savings Association subsequent to that date. These deposits, as well as many of the deposits of the "new" depositors who first deposited after July 9, 1959, were induced by the advertisement and offer and delivery of "expensive premiums", many as an inducement for deposits in varying amounts. That is, modest deposits were rewarded by premiums of modest value such as cameras and household appliances, while substantial deposits were rewarded by premiums which were of substantial value, to wit, expensive luggage and color television sets.

There is no evidence of any tender of the return of the "expensive premiums" or their equivalent as a condition precedent to the claimed "rescission" granted by the courts below. There is no evidence as to the knowledge and awareness or notice of the depositors of the two tentative "classes", as to fraud, as declared by the District Court.

All of the depositors in the City Savings Association, held by this Court to be shareholders subject to the Securities Exchange Act, have one nexus, that is, they compose a universal class which has been defrauded.

Proceedings In The District Court

This suit was commenced on July 24, 1964 by a Complaint which alleged that the Plaintiffs were depositor-shareholders in the City Savings Association of Chicago

and made their deposits subsequent to July 23, 1959, and that within the purview of the Securities and Exchange Act of 1934, had been induced to purchase their securities because of false and misleading statements, (A. 10).* The Plaintiffs-Respondents claim the right to rescind their purchases and to be placed in the status of judgment creditors of the City Savings Association. This would afford them a priority or preference over the very substantial number of depositor-shareholders still remaining as account holders with the City Savings Association on the date of its seizure by the State of Illinois, Department of Financial Institutions, in June of 1964. The Complaint alleges frauds upon those persons who deposited after July 23, 1959, and in effect, claims a preference over any other depositors. This preference is claimed by the Plaintiffs on behalf of all other persons who made their deposits like the named Plaintiffs after July 23, 1959. (A. 10)

A motion to intervene on behalf of J. J. Lowenthal, et al, and all persons situated similarly to them, that is, depositors excluded by the Complaint from the class of Plaintiffs, was filed, (A. 25), and permission was granted to intervene, (A. 28), and these Intervening Defendants filed their Answer to the Complaint, denying that there was a class as claimed by Plaintiffs and contending that all depositors-shareholders were entitled to be treated alike (A. 29).

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*The Appellants have caused four copies of the "Appellants' Appendix" in the case of Tcherepnin v. Kirby, Nos. 17171, 17233, 17234, 17235, in the Court of Appeals to be filed as exhibits in the Court of Appeals. Citations to these books will be "E" followed by a page number. The Appendix filed in the Court of Appeals will be cited as "A" followed by a page number. References to materials reproduced in the Appendix to this petition will be "App." followed by a page number.

While the District Court took evidence on the motion to appoint receivers, (E. 114-546) it has never held a hearing or taken testimony on the question of frauds on the various depositor-shareholders of any period, or the fact of membership in respective "classes".

The District Court has acted upon what it conceived to be an authority created by the Manual for Complex and Multi-district Litigation, adopted under Section 1407 of Title 28, U.S.C. (A. 37). One of the contentions of the Intervening Defendants who are Petitioners in this appeal, is that the District Court did not, by reason of such Manual or Statute, acquire authority to dispense with a trial for the taking of proof regarding frauds upon the individual depositor-shareholders, or the total group of all stockholders.

The order of the Trial Court making a tentative determination of classes is set forth at A. 5, (Docket entry). The order of the Trial Court requiring memoranda from the respective tentative classes regarding the question of preference is set forth at A. 36-40.

Without a trial, the District Court entered its Findings of Fact, Conclusions of Law and Decree on December 30, 1969, after simultaneous Briefs, finding that the Class described in the Complaint was a Class and was the subject of fraud, and was entitled to a judgment granting them preference over all other creditors (A. 43). The Intervening Defendants (Petitioners here) filed a Motion for New Trial (A. 8, docket entry), which the Court denied but filed Amended Findings of Fact, Conclusions of Law and Decree (A. 48). The Intervening Defendants (Petitioners here) filed an additional Motion for New Trial (A. 52), which was denied, and was also stricken on motion of the Plaintiffs, (A. 9, docket entry). Timely Notice of Appeal was filed (A. 9, docket entry).

Facts

No testimony was taken on the issues involved in this appeal. However, the District Court undertook to consider as evidence, some of the proceedings which had occurred in connection with the appointment of a receiver and various reports and activities of the receivers, etc. The District Court said it would take judicial notice of records in the receivers' hands, as well (A. 38).

It should be noted that although the Complaint requests that the Class of Plaintiffs be determined as those who made deposits subsequent to July 23, 1959, the District Court's Decree directs that the preference should be extended to those who became depositor-shareholders subsequent to July 9, 1959 (A. 49).

REASONS FOR GRANTING THE WRIT OF CERTIORARI

1. The Court of Appeals below has decided an important question of federal law which has not been, but should be settled by this Court, to wit: Should the decision of this Court in *Tcherepnin, et al,* v. *Knight, et al,* 389 U.S. 332, 19 L.Ed. 2d 564 (1967) be construed and administered so as to create an inequitable preference in the assets of a defunct savings and loan association for about one-half of the depositors, and thus deprive more than 5,000 depositors of any share in the assets of the defunct institution?

2. The Court of Appeals below, in affirming the District Court, has departed so far from accepted and usual course of judicial proceedings, and has sanctioned such departure by a lower Court, so that the exercise of this Court's power of supervision is required. The District Court, without a trial, or even the benefit of summary judgment proceedings, arbitrarily decided, without the support of evidence, conclusive questions of fact and law and entered final judgment thereon which resulted in the exclusion of 5,000 depositors from sharing in the liquidated assets of the defunct City Savings Association.

3. This Court should decide whether, in an action for rescission of a contract for the purchase of securities, brought under the purported authority of the Securities Exchange Act, there is a requirement that Plaintiffs tender or return "expensive premiums" received as part of the contract of deposit and share purchase.

ARGUMENT

I.

THE DISTRICT COURT ERRED IN DETERMINING THAT ONLY ONE PART OF THE TOTAL CLASS OF ALL DEFRAUDED DEPOSITOR-SHAREHOLDERS WAS ENTITLED TO SHARE IN THE LIQUIDATED ASSETS OF CITY SAVINGS ASSOCIATION.

All parties to this case, including the receivers, have repeatedly stated at various times and to the District Court that there will be insufficient assets to repay the depositor-shareholders in total. There is little doubt but that if that part of the total number of depositor-shareholders who "first" became such subsequent to July 9, 1959 (See Decree, A. 49) is paid in full by preference indicated in the Decree, then there will be nothing left after fees and payment of other trade creditors and substantial liquidation expense, for the depositor-shareholders denied preference by the District Court's Decree.

In the purported trial of this preference issue of the case, the District Court entered an order orally, stating that it would be available by way of the reporter's transcript, directing the parties to file memoranda for the respective parties, that is, the Plaintiffs and the Intervening Defendants, upon a question:

> "WHICH, IF ANY, CLASS OR CLASSES OF DEPOSITORS ARE ENTITLED TO A PREFERENCE AS SECURITY HOLDERS AS DEFINED BY THE SUPREME COURT OPINION IN THIS CASE?" (A. 36-40)

At the session of Court in which this rule on the parties requiring memoranda was announced, the Court stated that it was taking authority to dispose of the case under

such a procedure from the "Manual for Complex and Multi-District Litigation", which Manual emanated from interpretations of Section 1407, Title 28 U.S.C. governing multi-district litigation. There is no multi-district litigation in this case. While this case has been protracted, that is, subject to delay due to two prior appeals and slow liquidation progress, there is no authority in that Manual for dispensing with trial. Indeed, the Manual provides for jury procedures, etc.

The following quotation appears on the first page of the Manual for Complex and Multi-District Litigation:

> "There are no inherently protracted cases, only cases which are unnecessarily protracted by inefficient procedures and management."

The District Court, in appointing counsel to represent the Intervening Defendants tentatively found to be a class (A. 28, 29), directed especially that counsel was not to duplicate activities undertaken by others in the case, and stated that there would be no fees allowed or paid for any duplicating efforts. Accordingly, counsel for the Intervening Defendants have scrupulously avoided such duplicating activities which they considered would not contribute to the progress of the case.

This policy was adopted in order to avoid uselessly encumbering the record and to avoid performing any acts which the District Court might find were objectionable for duplicating and for which the District Court would probably deny compensation.

It is respectfully submitted that from the indefinite order of the District Court, purporting to admit evidence in wholesale fashion without foundation or opportunity to object, and as a basis for determining individual frauds, which of course involve intent of parties, there is no way to determine that any single finding of fact or conclusion of law

is supported by competent material evidence. Many of the findings appear to be a paraphrasing of the Complaint. In the taking of evidence on the question of the appointment of receiver, the evidence of the Plaintiff and of respective liquidators and some official defendants was orally heard, and the testimony of liquidators and appraisers was also heard. On this evidence, the District Court ultimately appointed receivers. Counsel for the Intervening Defendants diligently attended these hearings and determined that insofar as the issue of the sufficiency of evidence for the appointment of receivers was concerned, there was no necessity for the Intervening Defendants to duplicate or add to the evidence offered *on that issue,* which was the only issue then pending and subject to hearing by the District Court. It should be noted that during the colloquy prior to the taking of evidence on the issue of the appointment of a receiver, the Intervening Defendants, by one of their attorneys, Carl M. Walsh, stated to the Court,

> "Our only other observation I wish to make, your Honor, as intervenors from our observation of the conduct of this liquidation we now favor and do request that you do appoint a receiver both to conserve the assets and to conduct the liquidation." (E. 142-143)

Prior to the entry of the District Court's order ruling that counsel for the two tentative classes should file memoranda on the question of preference, the Court had directed the parties to attempt to stipulate as to facts pertinent to that issue. When this appeared to the District Court to be impossible, he ordered the memoranda by the parties and entered his Decree subsequent thereto with no trial and no taking of evidence on the issue.

The motion for new trial filed by the Intervening Defendants in this case and attacking the Findings of Fact and Conclusions of Law and Decree, specifically points out errors in these Findings, etc. (A. 50-57). The motion also

included a contention that the Intervening Defendants were denied due process of law since the judgment was entered without the taking of evidence and without a trial (A. 57). There appears to counsel for the Intervening Defendants no question but that all depositor-shareholders of City Savings Association were substantially defrauded. Since this is the case, there is no point in determining which were the most defrauded since the fact that they were defrauded entitles them to equal treatment, as a single class, and the artificial preferences sought by the Plaintiffs in their Complaint and treated by the District Court in its Decree are erroneous.

It has been the contention of the Intervening Defendants throughout this case, that so far as fraud is concerned with reference to depositor-shareholders, there is but one Class, and that is the defrauded depositor-shareholders which includes all, regardless of the time of purchase or investment, since the frauds perpetrated on them were of long standing and were repeated and continuing.

As an example of the specific error in the findings of the District Court, attention is called to evidence taken on the question of receivership and the colloquy before testimony began. Mr. O'Laughlin, attorney for the liquidators, stated to the Court,

> "On May 8, 1959, City Savings Association, and this is the Apple Orchard property, there was a sale. There was a sale of property for $170,660. This is the so-called Saum property. Mr. Saum received $170,000 for this property.
>
> "Within the same week, if the Court please, and almost before the delivery of the deed, City Savings and Loan Association loaned out $455,000 on this property. This is the problem of this litigation." (E. 120, 121)

The Court thereupon remarked, "That would seem to be obvious fraud." (E. 121)

The District Court found, in its Paragraph 10 of Findings of Fact, (A. 47), that: "Extensive fraudulent mortgage loans were made since July 9, 1959, particularly in the Apple Orchard and Howie-in-the-Hills developments. The insolvency of City Savings Association occurred primarily as a result of these loans." No mention was made or apparent consideration given to the fact that a loan of $450,000 upon property purchased for $170,000 occurred on May 8, 1959. Of course, there was no possible way in which the Plaintiffs' funds could be involved in the May 8, 1959 week's transactions. Obviously, the funds of the pre-July 9, 1959 or July 23, 1959 depositors were involved in this Apple Orchard "obvious fraud" transaction.

No tracing of funds has ever occurred, that is, with regard to a determination of the disposition of the funds of depositors subsequent to July 9, 1959 or July 23, 1959 and the funds deposited by the previous depositor-shareholders. The District Court made a finding in its determination in support of the order appointing receivers, which was sustained by this Court of Appeals (*Tcherepnin v. Kirby*, 416 F.2d 594), as follows:

> "The federal rights asserted in this action may attach to all the assets of City Savings Association. It is impossible at this point to separate those assets to which a federal right attaches from such other assets as may remain in City Savings Association; *the assets are hopelessly commingled.* Moreover, it is probable, according to plaintiffs' accountants' report, that the assets of City Savings Association may not be sufficient to satisfy the federal rights now asserted herein even under the most restrictive interpretation of those rights. There is also the possibility that upon the trial hereinafter set all depositors may be found to possess federal rights, although obviously no such finding can be made at this time. In any event all depositors have now joined in the present motion for appointment of a receiver. (Emphasis added)

"I shall invite the Securities Exchange Commission whose brief *amicus curiae* was of major assistance in the determination of the securities issue herein to join again as *amicus* in the trial of the cause when the respective rights depositors will be adjudicated."* (E. 99)

It was pointed out to the District Court by the Intervening Defendants that the securing by the officers of City Savings Association, of permanent proxies included in fine print in the application card to be signed by the prospective depositor-shareholder and the re-use of those proxies throughout all periods involved in order to continue the same set of persons including Mensik, as Directors and officers, and to perpetuate the power and ability to perform frauds, misrepresentations and concealments established in this case unequivocally, bring all depositor-shareholders who unwittingly permitted this practice to continue within the purview of those who should be allowed general participation in the liquidated assets of City Savings Association.

Copies of subscriptions for shares, respectively dated March 3, 1961 and March 12, 1957, thus showing the practice before and after 1959, are reproduced and included herein as exhibits at the conclusion of this brief. (Appendix G App. 36)

In Paragraph 17 of the Complaint of the Plaintiffs (A. 15-17), the Plaintiffs recite details of a "substantial flow of adverse publicity concerning Oren Mensik". It is amazing that these Plaintiffs, who urge in this Complaint that the publicity related to an investigation and indict-

* It should be noted that the Securities Exchange Commission reported to the District Judge that it had no opinion to express insofar as the filing of a memorandum on the question of preference was concerned (A. 13, 55).

ment of Mensik in Baltimore, Maryland on mail fraud charges and publicity of his trial on that subject and his subsequent re-indictment in 1963, and his ultimate conviction from mail fraud charges from which he was then appealing, would claim that this publicity did not affect the Plaintiffs-Respondents who were depositor-shareholders after July 23 or 9 of 1959. Any degree of investigation would indicate that practically every report in the newspapers or on the air regarding Mensik and his criminal problems in Maryland contained reference to his presidency of the City Savings Association of Chicago. The Chicago Daily News was especially diligent in following the litigation of Mensik, and it is difficult to understand how this news failed to penetrate the minds of all of the depositor-shareholders, including those who deposited before 1959 and those who deposited after 1959, and those who deposited in both periods.

Although the District Judge in this case has chosen to bring within the arbitrary grant of preference only those who "first" deposited subsequent to July 9, 1959, there are some depositor-shareholders who deposited and withdrew their entire accounts prior to 1959, but again succumbed to the blandishments of advertising, gifts of "expensive premiums", additional half per cent dividend as compared with other savings institutions, and opened new accounts.

There is no question but that most of those who "first" deposited prior to July 9, 1959, were induced to close these accounts and subscribe for new shareholder accounts after July 9, 1959. Since no trial has been held, it is impossible to say with certainty what inducement impelled each or most of these shareholders whose claims depend upon shares acquired by reason of their new applications subsequent to July 9, 1959. It is believed by counsel that these

persons were induced to make these new subscriptions for shares by the implied promise that they would be permitted then to become withdrawable shares. Whether they secured premiums is not clear, and no evidence on this point has been taken by the District Court.

In connection with this situation, counsel for the Intervening Defendants filed a motion on November 12, 1968 for examination of accounts and re-alignment of parties, and no order was entered on said motion (A. 33-35).

This motion showed the following tabulation concerning the various types of accounts in existence when City Savings Association closed, in the belief of counsel for the Intervening Defendants:

"1.	Installment shares	$ 53,364.99
2.	Optional shares	536,084.69
3.	Prepaid shares	3,601,849.88
4.	Fully paid shares	1,451,829.69
5.	Investment shares-investment plan	5,225,606.55
6.	Investment shares-thrift plan	17,682,938.74
7.	Christmas Club	20,072.63
		$28,571,747.17

"That of the first 4 categories mentioned above, all persons who hold said deposits became depositor-shareholders prior to July 9, 1959, and said accounts were existent prior to July 9, 1959. Of the 5th class, 'Investment shares-investment plan', nearly all of the holders became depositor-shareholders prior to July 9, 1959. Of the 6th category, 'Investment shares—thrift plan,' a large majority became depositor-shareholders prior to July 9, 1959, and thereafter, changed their accounts and received new accounts books therefor after July 9, 1959. A comparatively small number of these added deposits after July 9, 1959, and a small number became new depositors, for the first time,

after July 9, 1959. As to the 7th class, 'Christmas Club' depositor-shareholders, the movant is not informed as to when these depositor-shareholders opened their accounts. The 6th category of depositor-shareholders, 'Investment shares - thrift plan', are by far the largest group of depositor-shareholders." (A. 34)

All of those said to have exchanged accounts or acquired new evidence of shareholding by sales inducement after July 9, 1959, were also induced to sign application cards for the subscription of shares containing the same concealed proxy agreement signed by all other share purchasers. (See Appendix G attached, App. 36)

It is obvious that the great group of depositors in the City Savings Association were not selective and sophisticated investors who read fine print, but were subject to the blandishments of those who desired to continue City Savings Association operation. It is impossible without a trial to determine which of those knew Mensik was in control, and had faith in him despite his adverse publicity and court proceedings, and how many didn't care who the President was, just so they got their "expensive premium" and a ½ per cent more interest than other institutions offered.

It must be considered as well by this Court that prior to 1964, the Supreme Court had not held that Savings and Loan depositors were depositor-shareholders entitled to the construction of Securities and Exchange Commission protections and provisions. Indeed, the District Judge certified the question to the Court of Appeals, and the Court of Appeals decided adversely to the Plaintiffs, that is, that depositors in State Savings and Loan Associations were not the holders of "securities" (*Tcherepnin* v. *Knight*, 371 F.2d 374). Thereafter, the Supreme Court held that investors in the City Savings Association were shareholders

of securities as defined by Section 3(a)(10) of the Securities Exchange Act of 1934. The Supreme Court said, among other things,

> "This case involves only the threshold question of whether a federal court has jurisdiction over the complaint filed by the petitioners—a question which turns on our construction of the terms 'security' as defined by §3 (a) (10) of the Securities Exchange Act of 1934. It is totally irrelevant to that narrow question of statutory construction that these petitioners, if they are successful in their federal suit, might have rights in the limited assets of City Savings superior to those of other investors in that Association."
>
> (*Tcherepnin* v. *Knight*, 389 U.S. 332, 346)

The Supreme Court further stated at 389 U.S. 346 that it fully agreed with dissenting Judge Cummings of the Court of Appeals that the investors in City Savings Association were not able to protect themselves, as well as investors in other types of securities, which had been afforded the protection of the Securities and Exchange Act of 1934.

Nearly every fraud which was perpetrated upon the class granted preference by the District Judge below, was equally perpetrated upon all other depositor-shareholders, and the evidence if fully heard would bear this out. Sometimes a degree of difference did exist. For instance, those who had deposited prior to July 9, 1959 were unable to withdraw their accounts after that date because their accounts were presumably "frozen" under State law. Under the Supreme Court decision, their contract was void, and these State court freezing provisions should not have applied and were void as to these shareholders of securities. Those who deposited after July 9, 1959, as a result of the bait held out to them by way of premiums such as umbrellas, cameras, luggage, television sets, etc., were likewise frozen under an agreement that they would not withdraw for a period commensurate with the value of the prize

or premium they had selected which depended upon the amount deposited. These were different ways of accomplishing the same purpose.

A practical way to resolve the relationships of the depositor-shareholders is by an audit and determination of the status of the shareholders by the receivers and a report to the District Court, with copies to the respective parties, and thereafter a trial, that is, a taking of evidence regarding the circumstances of a substantial number of the different types of shareholders, and especially of those who have their own counsel. It is the belief of counsel for the Intervening Defendants that such a trial will show that all depositor-shareholders of City Savings Association were very substantially defrauded.

If defrauded in the purchase of his shareholdings, the depositor-shareholder has a void contract. Everyone was defrauded by the hidden proxies, copies of which are attached hereto as Appendix G (App. 36) and which even go so far as to provide that a withdrawal of the proxy shall only apply to the meeting to which it is addressed, and the proxy shall be in full force and effect again after the said meeting.

This material concealed in the fine print of the application for the purchase of shares or the making of a deposit, was the great effective swindle perpetrated on each and every shareholder. The other acts of omission, concealment and deception described in the Complaint of the Plaintiffs and concerning which some evidence was heard during the hearing for the appointment of receivers, will prove themselves to be equally applicable to all shareholders as of the close of the business of the City Savings Association in 1964.

The District Court has made a finding, No. 12, as follows:

"12. The defendant-intervenors and their class (i.e. pre July 9, 1959 depositors) had repeated public no-

> tice of the prior fraud and had actual knowledge of the limited withdrawal restrictions. Defendant-intervenors and their class also had notice of the facts brought out in the extensive state court litigation referred to in 3 above." (A. 48)

This finding is inconsistent with the philosophy that the Plaintiffs' class had no notice of the publicity that occurred prior to July 9, 1959. It appears that the District Court made a conjecture that some people did read the newspapers and some didn't; and some believed the newspapers and some didn't; and has overlooked totally the blandishments and inducements tendered to all depositor-shareholders by the management that had secured management by fraudulent proxies. It is inconsistent with the Complaint.

The District Court has failed to follow two decisions which the Intervening Defendants believe compel a holding that all defrauded depositor-shareholders had void contracts under 15 U.S.C., Section 78 cc(b) and should be equally treated under the law. In *J. I. Case* v. *Borak*, 377 U.S. 426, the Supreme Court said at 433-434:

> "We, therefore, believe that under the circumstances here it is the duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose. As was said in Sola Electric Co. v. Jefferson Electric Co., 317 US 173, 176, 87 L ed 165, 168, 63 S Ct 172 (1942):
>
> "'When a federal statute condemns an act as unlawful, the extent and nature of the legal consequences of the condemnation, though left by the statute to judicial determination, are nevertheless federal questions, the answers to which are to be derived from the statute and the federal policy which it has adopted.'
>
> "See also Tunstall v. Brotherhood of Locomotive Firemen & Enginemen, 323 US 210, 213, 89 L ed 187, 193, 65 S Ct 235 (1944); Deitrick v. Greaney, 309 US 190, 201, 84 L ed 694, 701, 60 S Ct 480 (1940). It is

for the federal courts 'to adjust their remedies so as to grant the necessary relief' where federally secured rights are invaded. 'And it is also well settled that where legal rights have been invaded, and a federal statute provides for a general right to sue for such invasion, federal courts may use any available remedy to make good the wrong done.' Bell v. Hood, 327 US 678, 684, 90 L ed 939, 944, 66 S Ct 773, 13 ALR2d 383 (1946). Section 27 grants the District Court jurisdiction 'of all suits in equity and actions at law brought to enforce any liability or duty created by this title . . .' In passing on almost identical language found in the Securities Act of 1933, the Court found the words entirely sufficient to fashion a remedy to rescind a fraudulent sale, secure restitution and even to enforce the right to restitution against a third party holding assets of the vendor. Deckert v. Independence Shares Corp., 311 US 282, 85 L ed 189, 61 S Ct 229 (1940). This significant language was used:

" 'The power to *enforce* implies the power to make effective the right of recovery afforded by the Act. And the power to make the right of recovery effective implies the power to utilize any of the procedures or actions normally available to the litigant according to the exigencies of the particular case.' At 288, 85 L ed at 194.

"See also Porter v. Warner Holding Co., 328 US 395, 90 L ed 1332, 66 S Ct 1086 (1946); Mitchell v. Robert De Mario Jewelry, Inc., 361 US 288, 4 L ed 2d 323, 80 S Ct 332 (1960); Schine Chain Theatres, Inc. v. United States, 334 US 110, 92 L ed 1245, 68 S Ct 947 (1948)."

The Supreme Court said in *Mills* v. *Electric Auto Lite Company*, 396 U.S. 375, 24 L.Ed. 2d 593, at 600:

"As we stressed in Borak, §14(a) stemmed from a congressional belief that 'fair corporate suffrage is an important right that should attach to every security bought on a public exchange.",

"As a general rule, *restoration* of the parties to status quo *is a condition precedent* to the rescission of a contract by one of the parties thereto for fault of the other party. This rule applies where the rescission is based on fraud or misrepresentation, mistake, or a breach or failure to perform." (Emphasis added.)

12 ILP "Contracts" §348

"As a general rule *a party who seeks to rescind* a contract for fault of the other *must return, or offer to return, the consideration or whatever he has received under the contract* so that the other party may be placed in the same position in which he was before the contract was entered into." (Emphasis added.)

12 ILP "Contracts" §349

and by the American Law Institute's Restatement of the Law of Contracts:

"§480

(1) The power of any party, . . . to avoid a transaction for fraud or misrepresentation is conditional on an offer made promptly after acquiring knowledge of the fraud or misrepresentation to return the amount of any money or other performance received as part of the transaction, in substantially as good condition as when received by him."

The plaintiff's complaint pleads that as a part of their purchase of withdrawable capital shares of City Savings Association, the plaintiffs received "expensive premiums, such as TV sets, typewriters, Polaroid cameras, luggage, radios, hi-fi sets, and other items." (A. 18).

Yet, nowhere in the plaintiffs' pleading is there an offer to return these "expensive premiums", nor have any of these items actually been restored to City Savings by the plaintiffs.

Plaintiffs' action is brought under 15 U.S.C. 78 cc(b), (A. 14). The Seventh Circuit Court of Appeals, in discussing 15 U.S.C. 78 cc(b) in *Bankers Life and Casualty Co.* v. *Bellanca Corporation,* 288 F.2d 784 at 787 (7 Cir. 1961), *cert. denied* 368 U.S. 827, 7 L.Ed. 2d 31, 82 S.Ct. 47 stated that the "rights of the purchaser are to be measured by the law of the jurisdiction involved. Here the contract was made in Illinois. * * * The law of Illinois governs." The contracts here were also made in Illinois.

The Illinois Supreme Court has said in regards to rescission that: "The very idea of rescinding a contract implies that what has been parted with shall be restored on both sides." *Dowing* v. *Harris Trust and Savings,* 318 Ill. 323, 149 N.E. 256.

Clearly, the plaintiffs have never fulfilled the conditions precedent to their obtaining rescission, nor have they even plead the condition precedent of restitution or an offer of restitution. The plaintiffs' complaint does not state a cause of action, and the District Court was without jurisdiction to enter the judgment in this case. The judgment should be reversed.

CONCLUSION

For the foregoing reasons, the Petitioners respectfully submit that their Petition for Writ of Certiorari should be granted.

Respectfully submitted,

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September, 1972

APPENDIX A

In the

United States Court of Appeals

For the Seventh Circuit

SEPTEMBER TERM, 1971 — SEPTEMBER SESSION, 1971

No. 18581

ALEXANDER TCHEREPNIN, et al.,

Plaintiffs-Appellees,

v.

ROBERT FRANZ, et al.,

Defendants,

J. J. LOWENTHAL, et al., CLASS OF INTERVENING DEFENDANTS,

Appellants.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.
No. 64 C 1285 — WILLIAM J. CAMPBELL, *Judge.*

ARGUED NOVEMBER 1, 1971 — DECIDED MAY 15, 1972

Before MAJOR* and HASTINGS, *Senior Circuit Judges,* and PELL, *Circuit Judge.*

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* Senior Circuit Judge Major, whose death occurred on January 4, 1972, heard oral argument, but did not participate in the adoption of this opinion.

PELL, *Circuit Judge.* This court once again is confronted with a problem stemming from the collapse of City Savings Association (CSA), a savings and loan institution chartered by the State of Illinois and presently under the control of federal receivers. The main contention of the appellants here, a group of depositors-shareholders, is that the district court erred in concluding that another group of depositors-shareholders (the plaintiffs in the action) has a preference in the distribution of CSA's assets. The appellants assert they, too, were defrauded in violation of the anti-fraud provisions of the Securities Exchange Act of 1934 and that, therefore, but one group or class of depositors-shareholders exists, all members of which are entitled to rescission under the Act with a resultant equal footing at the time of the distribution of remaining CSA assets.

I

Because other decisions concerning CSA have chronicled much of its complicated and unfortunate history,[1] we will discuss the factual background only to the extent necessary to explain the present appeal. Further reference herein to the plaintiffs below will usually be as the "post-July 9, 1959 depositors" and to the intervening defendants, the appellants on this appeal, as the "pre-July 9, 1959 depositors."

In April 1957, the Auditor of Public Accounts of the State of Illinois took custody of CSA and suspended payments to depositors. Pursuant to a decree entered

[1] The reported decisions include *Mensik* v. *Smith*, 18 Ill.2d 572, 166 N.E.2d 265 (1960); *Tcherepnin* v. *Franz*, 277 F. Supp. 472 (N.D. Ill. 1966); *Tcherepnin* v. *Knight*, 371 F.2d 374 (7th Cir.), *rev'd*, 389 U.S. 332 (1967); *Tcherepnin* v. *Kirby*, 416 F.2d 594 (7th Cir. 1969); and *Tcherepnin* v. *Franz*, 316 F. Supp. 714 (N.D. Ill. 1970).

by the Circuit Court of Cook County, Illinois, in December 1957, the State Director of Financial Institutions restored custody of CSA to its officers and directors. The association reopened to the public on December 19, 1957, but on a limited withdrawal rotation basis as to its then existing accounts.

In February 1959, the Circuit Court entered a final decree adopting the findings and conclusions of its December 1957 decree. In *Mensik* v. *Smith*, 18 Ill. 2d 572, 166 N.E.2d 265 (1960), the Supreme Court of Illinois affirmed the decree returning the operation of CSA to its management. However, in June 1964, the Director of Financial Institutions of the State of Illinois seized CSA from its officers once again. He immediately closed CSA. Acting through the Director, the State retained custody of CSA until early September 1964, when three liquidators took custody under a plan of voluntary liquidation.

Unhappy with the course of the voluntary liquidation, the post-July 9, 1959 depositors moved for the appointment of a federal receiver. In September 1968, the district court below granted their motion and appointed two federal receivers. They have managed the assets of CSA since September 19, 1968.

While CSA was in the custody of the State of Illinois, post-July 9, 1959 depositors instituted a class suit which allegedly represented over 5000 investors. In their complaint, they claimed that they had purchased withdrawable capital shares in CSA after July 23, 1959,[2] and that the

[2] Notwithstanding the date stated in the complaint, the district court specified July 9, 1959 as the operative date for plaintiffs' class. On that date, an amendment to the Illinois Savings and Loan Act permitting new or additional capital accounts, which were to be withdrawable at will, became effective.

sales of these shares to them were void under § 29(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78cc (b). They asked that the sales be rescinded. The complaint alleged that the withdrawable capital shares they had purchased from CSA were securities within the meaning of § 3(a)(10) of the Act, 15 U.S.C. §78c(a)(10), that in buying the shares they had relied upon printed solicitations that CSA had mailed to them, and that these solicitations contained false and misleading statements in violation of § 10(b) of the Act, 15 U.S.C. § 78j(b), and of Rule 10b-5 adopted thereunder, 17 CFR § 240.10b-5. More specifically, the complaint alleged that the mailed solicitations erroneously portrayed CSA as a financially strong institution and its shares as desirable investments.

The class that the appellants here represent consists largely of those persons originally represented by the 100 Cents on the Dollar Shareholders Committee which was permitted in January 1966 to intervene in the Securities Exchange Act suit as a party-defendant. As such, it answered plaintiffs' complaint by denying or by claiming lack of information about the commission of the frauds alleged in the complaint. It contended that the plaintiffs' suit was a spurious class action and should be dismissed. Also, together with the named defendants (not parties to this appeal), it sought dismissal of the plaintiffs' action on the jurisdictional grounds ultimately rejected by the United States Supreme Court in *Tcherepnin* v. *Knight*, 389 U.S. 332 (1967). Until the Supreme Court in *Tcherepnin* decided otherwise, the intervening defendants maintained that Illinois law controlled the resolution of CSA's problems.

In *Tcherepnin* v. *Knight, supra*, the United States Supreme Court held that the federal district court had jurisdiction of the action instituted by the post-July 9,

1959 depositors because a withdrawable capital share in a state-chartered savings and loan association was a "security" within the meaning of the Securities Exchange Act of 1934. At the end of its opinion, the Court remarked:

> "The respondents have argued that we should not declare the petitioners' withdrawable capital shares securities under § 3(a)(10) because the petitioners, if they are successful in their suit for rescission, will gain an unfair advantage over other investors in City Savings in the distribution of the limited assets of that Association, which is now in liquidation. This argument, at best, is a *non sequitur*. This case in its present posture involves no issue of priority of claims against City Savings. This case involves only the threshold question of whether a federal court has juridiction over the complaint filed by the petitioners—a question which turns on our construction of the term 'security' as defined by § 3(a)(10) of the Securities Exchange Act of 1934. It is totally irrelevant to that narrow question of statutory construction that these petitioners, if they are successful in their federal suit, might have rights in the limited assets of City Savings superior to those of other investors in that Association." 389 U.S. at 346.

II

In an order dated March 10, 1970, the district court concluded that the plaintiffs and their class were purchasers of securities within the meaning of the Securities Exchange Act. The establishment of their accounts, which were withdrawable at will, had resulted from a new section of the Illinois Savings and Loan Act that became effective on July 9, 1959. The new section provided in substance that an association could accept new and additional withdrawable capital accounts and that such new or additional accounts would not be subject to the section of the Illinois Act restricting withdrawals.

The court found that, before making their purchases, the plaintiffs had not been advised that CSA was operating under a limited withdrawal restriction as to all the pre-July 9, 1959 accounts. Further, in CSA's extensive advertising campaign subsequent to the effective date of the statutory amendment and continuing through July 26, 1964, soliciting new deposits, CSA made numerous fraudulent misrepresentations, misstatements and omissions.

The court specifically found that CSA's insolvency resulted primarily from "[e]xtensive fraudulent mortgage loans" that CSA made after July 9, 1959, particularly in the Apple Orchard and the Howie in the Hills developments. The court also stated that, without the knowledge of the plaintiffs and their class, CSA had illegally used "considerable funds" deposited by them on or after July 9, 1959, to make payments to pre-July 9, 1959 depositors.

In light of all the above, the court concluded "as a matter of law" that the plaintiffs and their class had been defrauded within the meaning of the anti-fraud provisions of the Securities Exchange Act. As defrauded purchasers of securities, they had a right to rescind their purchase agreements and, upon the rescission, were entitled to assert a claim against CSA as judgment creditors having priority over "other shareholders or depositors . . . [and] any other creditors."

The court found that only the plaintiffs and their class had properly pleaded a claim under the Securities Exchange Act. The pre-July 9, 1959 depositors "had repeated public notice of the prior fraud and had actual knowledge of the limited withdrawal restrictions. . . . [They] also had notice of the facts brought out in the extensive state court litigation. . . ."

The pre-July 9, 1959 depositors have appealed from the district court's order of March 10, 1970.

III

The appellants maintain that the procedure followed below denied them due process of law. The district court allegedly dispensed with a trial and admitted "evidence in wholesale fashion without foundation or opportunity" for the intervening defendants to object. Thus, there allegedly is no way to determine whether any single finding of fact or conclusion of law is supported by competent, material evidence.

On October 18, 1968, the district court had entered an order tentatively delineating the two classes but not determining priorities. The court then directed the parties to attempt to stipulate to facts pertinent to that issue. On January 23, 1969, the court, anxious to proceed speedily to a resolution of the cause, suggested that it was unnecessary to wait until the detailed stipulation was completed. It declared that "[i]t is apparent at this juncture that the determination of certain legal questions will expedite the ultimate disposition of this seemingly unwieldy case and will properly fix the bounds of discovery which now appear endless." Accordingly, the court ordered each of the interested parties to submit a memorandum of law[3] addressed to the question: "Which, if any, class

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[3] The appellants maintain that the court ordered memoranda when it appeared "impossible" for the parties to agree to the facts. However, at the January 23, 1969 proceedings, the court gave the following reasons for not waiting until a full stipulation could be worked out:

> "I want to proceed speedily. . . . I . . . comprehend that the facts to which you are asked to stipulate might enter the realm of conclusions, and also that actually the basis for all of the

or classes of depositors are entitled to a preference as security holders as defined by the Supreme Court opinion in this case [*Tcherepnin* v. *Knight*, 389 U.S. 332 (1967)]?" It stated the parties would be permitted to file answering briefs. Thereafter, "The Court will take the matter of that determination without oral argument."

In so proceeding, the court purported to be following the "spirit and teachings" of the Manual for Complex and Multidistrict Litigation, particularly Sections 0.22 and 1.8.[4] "[I]t is obvious to me that we are here dealing with

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(Footnote continued)

stipulation, if one could be agreed upon, is already before the Court. . . . Counsel have . . . advised the Court that substantial progress has been made toward filing a detailed stipulation. At the moment, however, progress on the stipulation and discovery in general has been slowed by the claimed unavailability of certain information, namely, the breakdown as to when each of the numerous depositors made his deposit and therefore into which class he properly falls. [Hence, it is necessary to resolve certain legal issues to expedite matters.] . . . The memorandum need not assume nor specify the number of persons in each class claimed to be a class of security holders, or the number of persons, if any, allegedly not possessing the rights of a security holder."

[4] Section 0.22, "Classes of potentially complex cases," provides:

"Cases in the following classification may require special treatment in accordance with the procedures in this Manual: . . . (f) individual stockholders', stockholders' derivative, and stockholders' representative actions; . . . (j) class actions or potential class actions; or (k) other cases involving unusual multiplicity or complexity of factual issues."

Section 1.8, "Early Determination of Special Legal Questions," reads in part:

"In some complex cases it becomes apparent at the preliminary pretrial conference or shortly thereafter that the determination of a legal question will expedite the disposition of the

what the Judicial Conference of the United States refers to as a 'protracted' or 'complex' case."

After explaining the course to be followed, the court declared, "*This case is now on trial.*" It then received in evidence (1) all documents and records in the custody of the receivers which were part of the files and records of CSA, (2) all accounting reports concerning the operations of CSA rendered either by Peat, Marwick, & Mitchell & Company or by Price-Waterhouse & Company, and (3) the complete transcript of the proceedings held on the motion for appointment of a receiver. The court clearly announced to the parties that they were free to comment on the evidence.[5] At the end of January 23, 1969 proceedings, the court said:

> "After such determination has been made, the Court will if then necessary enter an appropriate order specifying how the individual security holder may exercise his right to rescind the purchase of his se-

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(Footnote continued)

> cause. This is particularly the case where the nature and scope of discovery and further pretrial proceedings would be substantially affected by the determination of the preliminary legal question. . . . When desirable to expedite the cause, the court should provide an efficient method including discovery if desirable, and a time schedule for submission and determination of such preliminary legal questions."

[5] Specifically, the court stated:

> "Any party desiring to refer to any of the said documents, recordings or reports in its memorandum or at any time may do so. The parties may present in their briefs any arguments as to the relevance or probative value of any evidence here admitted."

curities, *amd what if any proceedings are necessary to conclude the trial and enter final judgment.*

. . .

"Proceed with the preparation of your briefs, gentlemen.

"*Anything further*?"

The district court thus outlined for the parties how it intended to handle the case. The transcript shows no response to the court's query by counsel for the pre-July 9, 1959 depoistors. Those investors made no objection to this form of trial procedure. In response to questioning during oral argument, their counsel told this court that they had never offered any evidence nor had they been denied the right to offer evidence. Counsel further informed us that the district court had been willing to review any pertinent evidence that the parties brought to its attention.

The pre-July 9, 1959 depositors did not object to the evidence admitted below. Indeed, in their appellate briefs, they repeatedly concede the commission of the frauds charged in the plaintiffs' complaint.

In light of the above, we hold that the appellants were not denied due process of law.

The thrust of the appellants' substantive attack is that the division of depositors into two classes, one of which is entitled to a preference in CSA's liquidated assets, was arbitrary and inequitable. The pre-July 9, 1959 depositors emphatically contend that they *too* were victims of the same kinds of frauds of which the plaintiffs complain. Hence, the two classes allegedly are *in peri causa*, and neither has priority over the other. In essence, the appellants are contending that there is only one class.

The plaintiffs emphasize that not only did the appellants not originally formally plead a securities fraud cause of action under the 1934 Act, but they never amended their pleadings to assert the violation of federal rights. The district court found that "[o]nly plaintiffs and their class have properly pleaded a claim under the Federal Securities Law."

In response, the appellants marshal the following arguments: (1) they did not think it was necessary for them to file pleadings asking for rescission because they believed they were "under the umbrella of the court's equity powers," and, pursuant to those powers, the court "would protect all the depositor-shareholders"; (2) the named defendants, in perpetrating the frauds complained of, principally used the "perpetual proxies" that were obtained from all the depositors; and (3) the "exchange" after the 1959 cut-off date by many of the appellants of their pre-July 9, 1959 accounts for "new" accounts was a sale or transfer of securities.[6]

The first argument seems to imply that preferences are per se "bad." Such a contention is negated by an amplitude of legislation and court decisions creating priorities and preferences and developing criteria for determining the proper persons to constitute a valid "class."

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[6] CSA had established seven categories or types of withdrawable capital share accounts, four of which were in being prior to 1959 and three of which were established after July 9, 1959, the date that the "new" provision permitting accounts withdrawable at will became effective. The four "old" types of accounts were subject to the restrictions imposed in December 1957 by CSA's board of directors, acting pursuant to state law. The accounts first opened by the defendant-intervenors (the pre-July 9, 1959 depositors) were of the four restricted types.

The question before us is whether the district court erred in its application of these established legal principles. That is, the appellants' invocation of the judicial power "to do equity" does not relieve them of their obligation to show us how they come within the framework of the plaintiffs' pleadings, which alleged violations of Section 10(b) and Rule 10b-5. *J. I. Case* v. *Borak,* 377 U.S. 426 (1964), which the appellants cite, does not eliminate this requirement.

Underlying the second argument of the pre-July 9, 1959 depositors is the premise that the use by the named defendants of the permanent proxies to "perpetuate [their] power and ability to perform frauds, misrepresentations and concealments" is covered by Section 10(b) and Rule 10b-5. Those provisions involve the purchase or sale of a security. The solicitation of proxies or the giving of them or the failure to revoke a proxy is not by itself the purchase or sale of a security. Further, Section 14(a) of the Securities Exchange Act of 1934 and Rule 14(a) thereunder regulating proxy solicitation apply only to securities registered under Section 12 of the Act. Withdrawable shares such as those in CSA are exempt from such registration under Section 12(g)(2)(C) of the Act. The intervening defendants-appellants' reliance on *Mills* v. *Electric Auto-Lite Co.,* 396 U.S. 375 (1970), is therefore, misplaced.

The appellants' third argument is the heart of their claim that those pre-July 9, 1959 depositors who did exchange accounts come within the plaintiffs' class—that they also had federal rights violated.

Maintaining that those exchanges did not amount to new purchases, the plaintiffs characterize them as the illegal switching of accounts that were on a restricted withdrawal basis to ones free of such limitations. (Such switches allegedly violated state law.) We note that, during oral argument, counsel for the intervening defendants suggested that CSA's management had induced his clients to turn in their existing accounts for "new" ones by the representation that this would facilitate their right to withdrawal, that is, would enable them to come within the recent statutory amendment.

As the post-July 9, 1959 depositors point out, in addition to opposing originally the claim that the federal securities laws applied to CSA and to failing formally to pursue federal remedies, the pre-July 9, 1959 depositors contended in the district court "that those persons whose deposits were made prior to July 9, 1959, did not become members of the Plaintiff category by a mere change of passbook and nomenclature as to monies already on deposit." ["Motion for Examination of Accounts and Re-Alignment of Parties," filed November 13, 1968.] On this appeal, however, the appellants, in effect, urge us not to hold them to their previous omissions and contentions.

In support of their proposition that

> "the exchange of the appellants' class deposits to new accounts with the obtaining of new permanent proxies, subsequent to 1961, on false representations that this would enable the appellants to obtain their funds, was a purchase or sale of a security in which there was fraud and deception cognizable under § 10(b) of the Securities Exchange Act . . . and Rule 10(b-5),"

the pre-July 9, 1959 depositors request us to consider *SEC* v. *National Securities, Inc.*, 393 U.S. 453 (1969);

Swanson v. *American Consumer Industries, Inc.*, 415 F.2d 1326 (7th Cir. 1969); and *Superintendent of Ins.* v. *Bankers Life & Cas. Co.*, 404 U.S. 6 (1971). We do not find these cases dispositive of the issues raised on this appeal.

National Securities, supra, concerned a suit by the SEC alleging violations of § 10(b) and Rule 10b-5 arising out of misrepresentations and omissions of material facts in communications sent to shareholders of Producers Life Insurance Company in an attempt to secure approval of a merger between that company and an insurance firm controlled by National Securities. In reversing the dismissal of the complaint, the Supreme Court concluded that Producers' shareholders "purchased" shares in the new company by exchanging them for their old stock. It further found that Rule 10b-5 was applicable to the defendants' misstatements in their proxy materials. Judge Cummings of this court, in *Swanson, supra*, also relied upon by the appellants, well stated the "lesson" to be derived from *National Securities:*

> "It is no longer open to question that the exchange of shares in connection with a merger or sale of assets constitutes a 'purchase or sale' within the meaning of Section 10(b) and Rule 10b-5. *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 467-468. . . . The *National Securities* decision also makes clear that the fact that the vehicle for the accomplishment of a fraudulent scheme may be proxy materials subject to regulation under Section 14(a) is not a bar to the application of the broad anti-fraud provisions contained in Section 10(b) and Rule 10b-5. 393 U.S. at p. 468. . . . " (415 F.2d at 1330.)

Bankers Life does not involve any alleged proxy frauds. It is factually inapposite to the instant case and does not

support the proposition for which the appellants cite it.[7]

National Securities and *Swanson* do not show that the "exchange" that took place here was a "purchase or sale." Furthermore, even if we assume that a "purchase or sale" occurred, we fail to see how those pre-July 9, 1959 depositors who changed accounts, unlike the minority stockholders in *Swanson* or the shareholders of Producers Life in *National Securities,* worsened their situation by their action.

The parties disagree whether the exchanged-for accounts were subject to the severe restrictions on withdrawals to which the old accounts were subject. If the "new" accounts were not so limited, then the representations allegedly made to the appellants were true. That is, the pre-July 9, 1959 depositors who "switched" then did share whatever freedom of withdrawal the depositors who first invested in CSA after July 9, 1959, enjoyed. Also, the proxies executed after July 9, 1959, in connection with the opening of new accounts were similar to those "permanent proxies" to which the old accounts were subject. If

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[7] The question before the Supreme Court in *Bankers Life* was whether the pleading of the petitioner, liquidator of Manhattan Casualty Company, stated a cause of action. The complaint alleged that the defendants (who included an officer of Manhattan) had induced the company, in violation of the federal securities laws, to sell a block of securities owned by it on the false representation that it would receive the proceeds of the sale. (The complaint alleged that after the sale of the securities for full value, the defendants misappropriated and diverted the proceeds to their own use.) Reversing the lower courts, the Supreme Court held that the pleading was sufficient to state a cause of action under § 10(b) and Rule 10b-5. Those provisions were broad enough to cover the transaction complained of because the corporation suffered injury as a result of deceptive practices "touching its sale of securities as an investor."

the "new accounts of the pre-July 9, 1959 depositors were, in fact, as severely limited as to withdrawals as the "old" accounts were, then those depositors were in no worse a position than they had been before they effected the exchanges.

As we have already mentioned, the section under which the plaintiffs made their claims refers to misleading omissions or misstatements of material facts "in connection with the purchase or sale of any security." The plaintiffs' complaint and the district court's order focus on frauds perpetrated during a period subsequent to the time that the group designated by the district court as the pre-July 9, 1959 depositors first made their investments. It seems clear that if the appellants' post-July 9 dealings with CSA did not constitute "a purchase or sale,"[8] as the plaintiffs urge, then the appellants' criticisms of the findings of fact in this particular area are misdirected.

For example, the appellants challenge the following finding: "Extensive fraudulent mortgage loans were made since July 9, 1959 particularly in the Apple Orchard and Howie in the Hills developments. The insolvency of City Savings Association occurred primarily as a result of these loans." The pre-July 9, 1959 depositors refer to evidence that their funds were used in a fraudulent loan of $450,000 for the Apple Orchard development on May 8, 1959, that is, before the plaintiffs had invested in CSA. They claim that this reveals the illogic of differentiating among depositors, for all CSA investors were victims of the fraudulent loans.

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[8] This is a problem that we find not necessary to resolve finally.

The post-July 9, 1959 depositors contend, and we agree, that this argument fails to take into account the section of the 1934 Act under which the plaintiffs and their class pleaded. They had alleged that the misrepresentations and omissions in the advertising literature sent them after July 9, 1959 to June 1964 and which induced them to purchase CSA securities related to CSA's financial health. The $450,000 loan and *subsequent* improper loans contributed greatly to CSA's capital impairment. (The appellants do not dispute this.) The advertising inducing the plaintiffs and their class to invest in CSA did not inform them that fraudulent, capital-impairing loans had been made. The plaintiffs thus do what the defendant-intervenors arguably cannot do, namely, tie the May 1959 and later loans to fraudulent misrepresentations and omissions made in connection with the purchase or sale of a security. The specific loan to which the appellants advert as well, of course, as the subsequent loans were made after the appellants had been induced to invest in CSA.

In disputing the contention that the appellants come within the plaintiffs' class, however, the plaintiffs have assumed that only the opening of an account — the initial investment — is a purchase or sale of a security. Under Illinois law,[9] each depositor or account holder has a vote of one share for each hundred dollars or fraction thereof of the aggregate withdrawal value of his withdrawable capital account. Therefore, if any pre-July 9, 1959 account holder made new deposits after July 9 resulting in an increase in his voting shares, apparently he effected the purchase of a security. Also, if he opened an additional account after that date, a purchase of a security occurred.

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[9] Illinois Savings & Loan Act, ILL. REV. STAT. ch. 32, § 742(d)(2).

Even if there are some appellants who fit within the above categories, however, that alone does not bring them within plaintiffs' class. The core of the complaint is that CSA's financial difficulties were concealed from the plaintiffs and their class at the time they were induced to invest in CSA. Those pre-July 9, 1959 depositors (including those who "switched" types of accounts, if we assume *arguendo* that the exchange was a "purchase or sale" of a security) could not have been defrauded as alleged in the complaint if they had had notice of CSA's troubles.

The validity of the class division established by the district court rests heavily on the notice the pre-July 9, 1959 depositors allegedly had. The pertinent finding is:

> "The defendant-intervenors and their class (*i.e.* pre July 9, 1959 depositors) had repeated public notice of the prior fraud and had actual knowledge of the limited withdrawal restrictions. Defendant-intervenors and their class also had notice of the facts brought out in the extensive state court litigation. . . . "

CSA was closed to depositors for eight months while the State was in custody, April to December 1957. Shortly after the State seized CSA, the institution's chief executive officer filed a suit to restrain such custody. A petition for leave to intervene was filed in that case, purportedly on behalf of about 7000 shareholders of CSA who belonged to a group called the Shareholders' Committee for the Reopening of City Savings Association and on behalf of all other CSA shareholders similarly situated. They were permitted to intervene because they "would or might be bound by the judgment which would affect them and . . . [because] there was no one in the case directly representing their interests." The state court decisions in the case in which the shareholders intervened discussed the problems facing CSA.

The plaintiffs claim that the pre-July 9, 1959 depositors are bound by the state court litigation; that is, they had notice of the facts there brought out because of the intervention. However, the appellants maintain that, absent a showing in the federal district court of notice to the pre-July 9, 1959 depositors that anything was being said or done in their names in the state court proceedings, the state litigation cannot be deemed to have given them notice of anything.[10] Presumably they would also deny that they knew or should have known that the State closed CSA in 1957.

However, we need not rely on the notice allegedly arising from the state court proceedings.[11] The record supports the finding that the pre-July 9, 1959 depositors had notice that pre-1959 accounts were on a restricted withdrawal basis — important information that CSA failed to supply when soliciting the business of the plaintiffs and their class. The imposition of restrictions on withdrawals indicated that CSA was in an unsound financial position. In so holding, we reject the appellants' claim that notice or knowledge is a purely subjective matter entailing the interrogation of each shareholder or at least of a random sampling

[10] The Circuit Court of Cook County relinquished jurisdiction over CSA by its final decree of February 3, 1959. Hence, as the plaintiffs argue, they and their class as post-July 9, 1959 depositors were not bound by the state court proceedings nor can knowledge of the State's taking custody in 1957 be attributed to them.

[11] Nor do we rely on the extensive publicity which the appellants concede was accorded the affairs of CSA and of its prime moving spirit, C. Oran Mensik, during the last seven or so years that the institution's doors were open (and which did not necessarily abate when those doors periodically closed).

of the shareholders. The appellants must be deemed to have looked at CSA in their dealings with it through lenses tinted with knowledge, whether constructive or actual.

The pre-July 9, 1959 depositors have raised other contentions on this appeal, including one which was first presented at oral argument. We have considered all these contentions and find them without merit. Likewise, we have found it unnecessary to consider countervailing arguments of the post-July 9, 1959 depositors, such as that claims by the intervening defendants of fraud are barred by estoppel, laches, res judicata, or the Illinois five-year statute of limitations.

In sum, we agree with the district court that there are two basic classes of depositors, that only one of them properly pleaded a claim under Section 10(b) of the Securities Exchange Act, and that that class is entitled to priority. We are unpersuaded that the appellants are within the framework of the plaintiffs' complaint or that they are members of the plaintiffs' class.[12]

We modify the court's order regarding the class divisions, however, by including in the preferential class with the plaintiffs those investors in CSA who opened and

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[12] The court's finding of fact that "Without the knowledge of the plaintiffs and their class, considerable funds deposited by them on or after July 9, 1959 were used illegally to make payments to pre-July 9, 1959 depositors" was one factor leading to its conclusion that the appellants could not properly be considered members of plaintiffs' class. The appellants hotly contest the accuracy of the finding although they apparently did not object below to the evidence supporting it. Although we find it unnecessary to reach this point, we note that in an affidavit submitted to the district court, CPA George Weisbard analyzed the pertinent financial records and concluded that "the pre-July 24, 1959 depositors in substantial measure were paid out of the pockets of the post July 23, 1959 depositors."

closed accounts prior to April 25, 1957, the date the State first took custody of the institution and suspended payments to depositors, and who, after closing those accounts, did not open new accounts until after July 9, 1959. Because these depositors terminated their association with CSA before the handwriting was on the wall, they also were misled by CSA's failure to provide crucial information about the institution's financial instability.

As we have mentioned, the appellants do not really challenge the court's conclusion that the plaintiffs and their class have been defrauded. The substance of their attack on the court's order of March 10, 1970, is that the fraud findings are incomplete and should have included them. We do not share this view. We affirm the district court's conclusion that the plaintiffs and their class "have been defrauded within the meaning of the anti-fraud provisions of the Securities Exchange Act of 1934."

IV

Although we uphold the district court's order entitling the plaintiffs' class to preferences in the assets of CSA, we, like the district court, are acutely aware of the suffering CSA's insolvency has caused many depositors in both groups. From the evidence presented below, we gather that, unfortunately, not even the plaintiffs here, who were "successful in their federal suit," *Tcherepnin* v. *Knight*, 389 U.S. at 346, will survive the CSA debacle unscathed.

This case is remanded to the district court for further proceedings consistent with our decision.

AFFIRMED AS MODIFIED.

A true Copy:
Teste:

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Clerk of the United States Court of Appeals for the Seventh Circuit.

APPENDIX B

OPINION BY JUDGE PELL
UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT
Chicago, Illinois 60604

May 15, 1972

Before

HON. JOHN S. HASTINGS, *Senior Circuit Judge*
HON. J. EARL MAJOR, *Senior Circuit Judge*
HON. WILBUR F. PELL, JR., *Circuit Judge*

ALEXANDER TCHEREPNIN, ET AL., *Plaintiffs-Appellees,*
No. 18581 vs.
ROBERT FRANZ, ET AL., *Defendants,*
J. J. LOWENTHAL, ET AL., *Appellants.*

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Illinois, Eastern Division, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the judgment of the said District Court in this cause appealed from be, and the same is hereby, AFFIRMED, as MODIFIED, with costs taxed against the appellants, and that this cause be and the same is hereby REMANDED to the said District Court for further proceedings consistent with our decision, in accordance with the opinion of this Court filed this day.

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT
Chicago, Illinois 60604

June 20, 1972

Before
HON. JOHN S. HASTINGS, *Senior Circuit Judge*
HON. WILBUR F. PELL, JR., *Circuit Judge*

ALEXANDER TCHEREPNIN, ET AL., *Plaintiffs-Appellees,*

No. 18581 VS.

ROBERT FRANZ, ET AL., *Defendants,*

J. J. LOWENTHAL, ET AL., CLASS OF INTERVENING DEFENDANTS, *Appellants.*

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division

On consideration of the petition of appellants, J. J. Lowenthal, et al., for a rehearing by the Court in the above entitled appeal, and the panel having voted to deny a rehearing,

IT IS ORDERED that the petition of the appellant for a rehearing in the above entitled appeal be, and the same is hereby denied.

APPENDIX D

Order dated 12/30/69
IN THE UNITED STATES DISTRICT COURT
• • (Caption — No. 64 C 1285) • •

FINDINGS OF FACT, CONCLUSIONS OF LAW AND DECREE

The Court having determined that this is a case generally described as a "Protracted Case" and having taken this matter under the special procedures recommended by the Judicial Conference of the United States in the "Manual for Complex and Multidistrict Litigation" and having received all documents, files, and records of City Savings Association and all transcripts of proceedings into evidence and having reviewed the briefs and considered the arguments of all parties and being further fully advised, finds:—

1. Plaintiffs are depositors in City Savings Association who first opened their accounts after July 9, 1959.

2. Intervening defendants are depositors in City Savings Association who opened accounts prior to that date (prior to July 10, 1959) and not thereafter.

3. The Auditor of Public Accounts had taken custody of the Association on April 25, 1957 and suspended payments to depositors. Custody was restored to its Officers and Directors in December of 1957, but protracted state court proceedings continued for some time thereafter. See *Mensik* v. *Smith,* 18 Ill. 2d 572 (1960). The State again took custody on July 26, 1964.

4. Prior to July 9, 1959 and until July 26, 1964 City Savings Association was operating under Section 4-13(b) of the Illinois Savings and Loan Act (Ill. Rev. Stat. Ch. 32 §773(b)), which provides in substance, that if an Association has insufficient funds in the treasury and from current receipts to pay all matured accounts and applications for withdrawal, then withdrawals shall be restricted as to time and amount with part payments permitted only on a rotating basis.

5. On July 9, 1959 Section 4-13(h) of the Illinois Savings & Loan Act became effective. (Ill. Rev. Stat. 1959, Ch. 32, §773(h)).

6. Said Section 4-13(h) effective July 9, 1959, provides in substance that an Association may accept new and additional withdrawable capital accounts and such new or additional accounts shall not be subject to the provisions of Section 4-13(b) restricting withdrawals, but shall be withdrawable at will.

7. Depositors who opened accounts in City Savings Association after July 9, 1959, were never advised that City Savings Association was operating under a limited withdrawal restriction as to all pre July 9, 1959 accounts.

8. Without the knowledge of plaintiffs, considerable funds deposited by them as depositors in the post July 9, 1959 class were used illegally to make payments to members of the pre July 9, 1959 class.

9. In the period from July 9, 1959 through July 26, 1964 City Savings Association engaged in an extensive advertising campaign soliciting new deposits. This advertising contained numerous fraudulent representations, misstatements and omissions.

10. Extensive fraudulent mortgage loans were made since July 9, 1959 particularly in the Apple Orchard and Howie in the Hills developments. The insolvency of City Savings Association occurred primarily as a result of these mortgages.

11. Only plaintiffs and their class (i.e. post July 9, 1959 depositors) have properly pleaded a claim under the Federal Securities law.

12. The defendant-intervenors and their class (i.e. pre July 10, 1959 depositors) had repeated public notice of the prior fraud and had actual knowledge of the limited withdrawal restrictions. Defendant-intervenors and their class also had notice of the facts brought out in the extensive state court litigation referred to in 3 above.

13. The Securities and Exchange Commission, *Amicus Curiae* herein, has no legal opinion on the question now before the court.

Upon which findings of fact the court hereby concludes as a matter of law:—

1. The court has jurisdiction over the persons and subject matter of this action.

2. Plaintiffs, as purchasers of withdrawable shares in City Savings Association, are purchasers of securities within the meaning of the Securities Exchange Act of 1934.

3. By virtue of the misrepresentations, misstatements and omissions found above and made in connection with the purchase of a security, plaintiffs have been defrauded within the meaning of the anti-fraud provisions of the Securities Exchange Act of 1934.

4. Pursuant to the provisions of Section 29(b) of the Securities Exchange Act of 1934 (15 U.S.C. §78cc(b))

plaintiffs, as defrauded purchasers of securities have a right to rescind their purchase agreement.

5. Upon said rescission, plaintiffs are entitled to assert a claim against City Savings Association as creditors and are entitled to a preference or priority over other shareholders in the distribution of the proceeds in any liquidation by the Receivers of the Assets of the Association.

Upon said Findings of Fact and Conclusions of Law, it is hereby Ordered, Adjudged and Decreed: —

1. Plaintiffs and members of their class are entitled to rescind their security purchase agreements and the same are hereby deemed rescinded.

2. All other depositors similarly situated but not members of the plaintiffs class, i.e. all purchasers of withdrawable capital shares who first opened their accounts after July 9, 1959, but who have elected pursuant to Rule 23 (Fed.R.Civ.Proc.) to be excluded from the class, may likewise rescind their purchase agreement by filing within thirty days hereof an appropriate motion with the court stating such desire and intention.

3. All said depositor-purchasers who have rescinded their purchases or who shall so exercise their right to rescind are hereby declared to be judgment creditors of City Savings Association and are to be paid in the amounts of their respective purchases before payments of any amounts to other shareholders or depositors or to any other creditors.

Enter:

William J. Campbell
Chief Judge

December 30, 1969

APPENDIX B

Order dated 3/10/70

IN THE UNITED STATES DISTRICT COURT
• • (Caption — No. 64 C 1285) • •

ORDER

The motion of Intervening Defendants for New Trial and to vacate Findings of Fact, Conclusions of Law and Decree entered herein on December 30, 1969 is *denied*.

On the court's own motion, the Findings of Fact, Conclusions of Law and Decree entered on December 30, 1969 are amended to read as follows:

1. Plaintiffs are depositors in City Savings Association who first opened their accounts on or after July 9, 1959.

2. Intervening defendants are depositors in City Savings Association who opened any account prior to that date (prior to July 9, 1959).

3. The Auditor of Public Accounts had taken custody of the Association on April 25, 1957 and suspended payments to depositors. Custody was restored to its Officers and Directors in December of 1957, but protracted state court proceedings continued for some time thereafter. See *Mensik* v. *Smith*, 18 Ill. 2d 572 (1960). The State again took custody on July 26, 1964.

4. Prior to July 9, 1959 and until July 26, 1964 City Savings Association was operating under Section 4-13(b) of the Illinois Savings and Loan Act (Ill. Rev.Stat. Chap. 32 §773(b)), which provides in substance, that if an Association has insufficient funds in the treasury and from current receipts to pay all

matured accounts and applications for withdrawal, then withdrawals shall be restricted as to time and amount with part payments permitted only on a rotating basis.

5. On July 9, 1959 Section 4-13(h) of the Illinois Savings & Loan Act became effective. (Ill.Rev.Stat. 1959, Ch. 32, §773(h)).

6. Said Section 4-13(h) effective July 9, 1959, provides in substance that an Association may accept new and additional withdrawable capital accounts and such new or additional accounts shall not be subject to the provisions of Section 4-13(b) restricting withdrawals, but shall be withdrawable at will.

7. Depositors who first opened accounts in City Savings Association on or after July 9, 1959, were never advised that City Savings Association was operating under a limited withdrawal restriction as to all pre July 9, 1959 accounts.

8. Without the knowledge of plaintiffs and their class, considerable funds deposited by them on or after July 9, 1959 were used illegally to make payments to pre July 9, 1959 depositors.

9. In the period from July 9, 1959 through July 26, 1964 City Savings Association engaged in an extensive advertising campaign soliciting new deposits. This advertising contained numerous fraudulent representations, misstatements and omissions.

10. Extensive fraudulent mortgage loans were made since July 9, 1959 particularly in the Apple Orchard and Howie in the Hills developments. The insolvency of City Savings Association occurred primarily as a result of these loans.

11. Only plaintiffs and their class have properly pleaded a claim under the Federal Securities Law.

12. The defendant-intervenors and their class (i.e. pre July 9, 1959 depositors) had repeated public notice of the prior fraud and had actual knowledge of the limited withdrawal restrictions. Defendant-intervenors and their class also had notice of the facts brought out in the extensive state court litigation referred to in 3 above.

13. The Securities and Exchange Commission, *Amicus Curiae* herein, has no legal opinion on the question now before the court.

Upon which findings of fact the court hereby concludes as a matter of law:—

1. The court has jurisdiction over the persons and subject matter of this action.
2. Plaintiffs and their class, as purchasers of withdrawable shares in City Savings Association, are purchasers of securities within the meaning of the Securities Exchange Act of 1934.
3. By virtue of the misrepresentations, misstatements and omissions found above and made in connection with the purchase of a security, plaintiffs and their class, have been defrauded within the meaning of the anti-fraud provisions of the Securities Exchange Act of 1934.
4. Pursuant to the provisions of Section 29(b) of the Securities Exchange Act of 1934 (15 U.S.C. §78 cc(b)) plaintiffs and their class, as defrauded purchasers of securities have a right to rescind their purchase agreement.

3. Upon said rescission, plaintiffs and their class are entitled to assert a claim against City Savings Association as creditors and are entitled to a preference or priority over other shareholders in the distribution of the proceeds in any liquidation by the Receivers of the Assets of the Association.

Upon said Findings of Fact and Conclusions of Law, it is hereby Ordered, Adjudged and Decreed:—

1. Plaintiffs and members of their class are entitled to rescind their security purchase agreements and the same are hereby deemed rescinded.

2. All other depositors similarly situated but not members of the plaintiffs class, i.e. all purchasers of withdrawable capital shares who first opened their accounts on or after July 9, 1959, but who have elected pursuant to Rule 23 (Fed.R.Civ.Proc.) to be excluded from the class, may likewise rescind their purchase agreement by filing within thirty days hereof an appropriate motion with the court stating such desire and intention.

3. All said depositor-purchasers who have rescinded their purchases or who shall so exercise their right to rescind are hereby declared to be judgment creditors of City Savings Association and are to be paid in the amounts of their respective purchases before payments of any amounts to other shareholders or depositors or to any other creditors.

Enter:

William J. Campbell
Chief Judge

March 10, 1970.

APPENDIX F

TRANSCRIPT OF PROCEEDINGS

A partial Transcript of Proceedings had at the hearing of the above-entitled cause before the Hon. William J. Campbell, Chief Judge of said Court, in his courtroom, United States Courthouse, 219 South Dearborn Street, Chicago, Illinois, on Thursday, January 23, 1969, at the hour of 10:00 o'clock a.m.

• • •

The Court: I stated the last time that I want to proceed speedily to a determination of this cause, and I intend to do so, and I, too, have been giving in the intervening period consideration to the various difficulties that you gentlemen have encountered, and I commend all of you for your efforts to arrive at a stipulation of as many of the facts as possible. I also comprehend that the facts to which you are asked to stipulate might enter the realm of conclusions, and also that actually the basis for all of the stipulation, if one could be agreed upon, is already before the Court. So I have come up with an alternative suggestion, and I wish you would all carefully follow it.

You may get copies of it later from the reporter, and it is going to be the order on which we proceed and we are going to proceed speedily.

From the many conferences and hearings heretofore held in this case, as well as from the reports presented as to results of conferences held by counsel, and from all that I have heard here this morning, it is obvious to me that we are here dealing with what the Judicial Conference of the United States refers to as a "protracted" or "complex" case. I cite Classes of Potentially Complex Cases, Section 0.22 of the Manual for Complex and Multidistrict Litigation.

It is likewise obvious that the complex features of this case particularly lend themselves to the advanced and enlightened procedures set forth in the Manual for Complex and Multidistrict Litigation which has been adopted as an official document of the Judicial Conference of the United States on September 19, 1968. Use of the Manual, like its predecessor, the 1960 Handbook of Recommended Procedures For the Trial of Protracted Cases, which is cited in 25 F.R.D. at page 351, has been urged upon all trial judges by the Chief Justice and the entire Judicial Conference. My long experience in the trial of complex cases; my experience with this case; and my familiarity with the purposes and objectives of the Manual led me to conclude at this time that the teachings of the Conference, through the Manual, are now exceptionally appropriate in this case.

In fact, while until today I have not specifically referred to the Manual in my conferences with you gentlemen or in this proceeding or formally categorized this case as Complex and Protracted, counsel have undoubtedly observed that we have been following many of the procedures recommended in the Manual. Following these procedures, counsel have diligently worked toward a simplification and definition of the issues wherein genuine disagreement exists.

Counsel have also advised the Court that substantial progress has been made toward filing a detailed stipulation. At the moment, however, progress on the stipulation and discovery in general has been slowed by the claimed unavailability of certain information, namely, the breakdown as to when each of the numerous depositors made his deposit and therefore into which class he properly falls.

It is apparent at this juncture that the determination of certain legal questions will expedite the ultimate disposition of this seemingly unwieldy cause and will properly fix the bounds of discovery which now appear endless.

As stated in the Manual for Complex and Multidistrict litigation, Section 1.8 at Page 25:

> "In some complex cases it becomes apparent • • • that the determination of a legal question will expedite the disposition of the cause. This is particularly the case where the nature and scope of discovery and further pretrial proceedings would be substantially affected by the determination of the preliminary legal question."

That substantially, Mr. Walsh, is what you referred to a little earlier this morning.

Accordingly, I now direct each of the interested parties in this cause, excluding, of course, the court-appointed Receivers, to file with the Court within 30 days from this date a memorandum of law addressed to the question: 'Which, if any, class or classes of depositors are entitled to a preference as security holders as defined by the Supreme Court opinion in this case?"

The memorandum need not assume nor specify the number of persons in each class claimed to be a class of security holders, or the number of persons, if any, allegedly not possessing the rights of a security holder.

Any interested party may file an answer to the brief of any opposing party within 15 days after the initial briefs have been filed. Replication, if any, may be filed within 5 days of the filing of any answering brief. Whereupon, the Court will take the matter of that determination without oral argument.

In further obedience to the spirit and teachings of the Judicial Conference and its Manual of Recommended Procedures, as well as to assist in the preparation of briefs heretofore ordered, this case is now on trial. The Court now receives in evidence all documents and recordings in the custody of its Receivers and therefore in the custody of the Court that were and are now a part of the files and records of City Savings Association. The Court also receives in evidence all accounting reports concerning the operations of City Savings Association rendered either by Peat, Marwick, Mitchell & Company or Price-waterhouse & Company and the complete transcript of the proceedings held on the motion for appointment of Receiver. Any party desiring to refer to any of the said documents, recordings or reports in its memorandum or at any time may do so. The parties may present in their briefs any arguments as to the relevance or probative value of any evidence here admitted.

Upon completion of the briefs, the Court will then determine which class or classes of persons before it are holders of securities within federal law and which, if any, of said classes are entitled to a preference. The Court will then order the Receivers to assemble by computer or otherwise as appears appropriate from all of the evidence such information as may be needed to determine which particular depositors are included within such class or classes of security holders. After such determination has been made, the Court will if then necessary enter an appropriate order specifying how to rescind the purchase of his securities, and what if any proceedings are necessary to conclude the trial and enter final judgment.

Mr. Clerk, enter an order accordingly.

Proceed with the preparation of your briefs, gentlemen.

Anything further?

We will recess to chambers.

APPENDIX G

EXHIBIT "A"

COPIES OF SUBSCRIPTION AGREEMENT CARDS INCLUDING PROXIES

Certificate No. 9263 - Prepaid Date 3-12-57

CITY SAVINGS ASSOCIATION
1656 West Chicago Avenue

Name BANKOWSKI, Edmund or Stephanie

Address 12128 So. Halsted St., Chicago 28, Ill.

1. The undersigned hereby subscribes for shares of the above named Association as follows:

4 shares at $75.00 per share

Said shares are subject to the By-Laws of the Association, resolution and regulations in force from time to time as ordered by the Directors of the Association and the Laws of the State of Illinois now in effect or hereafter amended governing Mutual Building Loan and Homestead Associations in force July 1, 1959 and to conditions printed on the Certificate of the various shares the undersigned may own from time to time.

2. JOINT-ACCOUNT PAYABLE TO EITHER OR SURVIVOR. We agree and declare that all funds now, or hereafter invested in this share account at City Savings Association are and shall be our joint property and owned by us as joint tenants with right of survivorship, and not as tenants in common; and upon the death of either of us any balance in said account shall become the absolute property of the survivor. The entire account of any part thereafter may be withdrawn by, or upon the order of, either of us or the survivor. It is especially agreed that withdrawals of funds by the survivor shall be binding upon us and upon our heirs, next of kin, legatees, assigns and personal representatives.

3. SHARES PROXY. The undersigned hereby appoint the President, the First Vice-President and Secretary of the Association, or the majority of them, to be the proxies of the undersigned, to vote at any meeting of shareholders as fully as the undersigned might or could if personally present. Unless revoked this proxy is to operate as long as the shares hereinbefore subscribed for shall stand in the name of the undersigned on the books of the Association, and if revoked any such revocation shall apply only to the meeting for or at which the right to revoke shall be exercised.

400.92 ✓ x Stephanie Bankowski

x Edmund Bankowski

Certificate No. 03531 Date March 3, 1961

CITY SAVINGS ASSOCIATION
1656 West Chicago Avenue

Name AGUZINO, Angelo or Olga (wife)

Address 723 N. Homan Ave., Chicago 24, Ill.

1. The undersigned hereby subscribes for shares of the above named Association as follows:

Said shares are subject to the By-Laws of the Association, resolution and regulations in force from time to time as ordered by the Directors of the Association and the Laws of the State of Illinois now in effect or hereafter amended governing Mutual Building Loan and Homestead Associations in force July 1, 1959 and to conditions printed on the Certificates of the various shares the undersigned may own from time to time.

2. JOINT-ACCOUNT PAYABLE TO EITHER OR SURVIVOR. We agree and declare that all funds now, or hereafter invested in this share account at City Savings Association are and shall be our joint property and owned by us as joint tenants with right of survivorship, and not as tenants in common; and upon the death of either of us any balance in said account shall become the absolute property of the survivor. The entire account of any part thereafter may be withdrawn by, or upon the order of, either of us or the survivor. It is especially agreed that withdrawals of funds by the survivor shall be binding upon us and upon our heirs, next of kin, legatees, assigns and personal representatives.

3. SHARES PROXY. The undersigned hereby appoint the President, the First Vice-President and Secretary of the Association, or the majority of them, to be the proxies of the undersigned, to vote at any meeting of shareholders as fully as the undersigned might or could if personally present. Unless revoked this proxy is to operate as long as the shares hereinbefore subscribed for shall stand in the name of the undersigned on the books of the Association, and if revoked any such revocation shall apply only to the meeting for or at which the right to revoke shall be exercised.

4. REQUEST FOR SAFE-KEEPING OF CERTIFICATE. The undersigned hereby request that the Association keep the Certificate of Shares numbered as above, for safe-keeping in the Association's vault.

296.72 ✓ Angelo Aguzino

Olga Aguzino

Book No. 24639 Date Mar 4/47

City Savings and Loan Association of Chicago

CONDITIONS

FIRST. Shares are subscribed for, issued and held subject to the laws of the State of Illinois, the by-laws of the association and rules of the Board of Directors in connection therewith.

SECOND. The Association may enforce retirement of shares in the manner provided by law. Shares may be withdrawn by the owner subject to such notice as may be required by the by-laws. Applications to withdraw before the shares have reached matured value will be filled in the order in which they are received. Maturing shares are automatically paid as of the date of maturity. Payments will be made in the order filed from appropriations made by the directors out of the regular receipts of the association,—except that in the event of unusual demands they may be paid, as provided by the laws of Illinois, in such other manner as the Board of Directors may from time to time by resolution determine.

THIRD. Upon payment of shares withdrawn before maturity, the owner is entitled to receive the dues paid in, and in addition, such portion of profits or dividend thereto[illegible] apportioned thereto as determined by the directors' withdrawal resolution in effect at the time of payment, less all lawful charges as may be due thereon. The directors may limit the aggregation dues payments acceptable per share.

FOURTH. The dividends on the within shares are limited at each apportionment of profits as prescribed on the face hereof and they are further limited by statute to the extent that in no event shall the shares participate in the profits for any period to a greater ratio than the profits or dividends declared and credited for that period upon fully participating shares.

FIFTH. In the event that the rate of available net earnings for any fiscal dividend period is less than the rate of dividend specified on this certificate the difference shall not be cumulative nor payable from future earnings.

SAVINGS SHARE PROXY

The undersigned hereby appoint the President, and the Vice-President, and the Secretary of the Association, or the majority of them, to be the proxies of the undersigned, to vote at any meeting of shareholders as fully as the undersigned might or could if personally present. Unless revoked this proxy is to operate as long as the shares hereinbefore subscribed for shall stand in the name of the undersigned on the books of the Association, and provided any such revocation shall apply only to the meeting for or at which the right to revoke shall be exercised.

SUBSCRIBER Erich Stainer (SEAL)

JOINT ACCOUNT—PAYABLE TO EITHER OR SURVIVOR

We agree and declare that all funds now, or hereafter, deposited in this account at City Savings and Loan Association of Chicago are and shall be, and shall remain, the property of us as joint tenants with right of survivorship, and not as tenants in common, and that upon the death of either of us any balance in said account shall become the absolute property of the survivor. The entire account of any part thereafter may be withdrawn by, or upon the order of, either of us or the survivor.

It is understood that withdrawals of funds by the survivor shall be binding upon us and our heirs, next of kin, executors, assigns and personal representatives

IN JOINT ACCOUNT _____ (Seal)

IN JOINT ACCOUNT _____ (Seal)

Book No. 24639 Class O

City Savings and Loan Association of Chicago

Certificate of Optional Payment Shares

THIS CERTIFIES THAT STAINER, Erich
821 N. Damen Ave.,

members of this association (is) (are) the owners of _____ Optional Payment shares upon which the initial payment of dues per share has been made.

The shares participate in the net earnings of the association up to but no excess of 1% per annum, such earnings to be apportioned periodically as the by-laws may provide. Dues payments on the shares shall be made in such amount or amounts and at such time or times as the owner may elect until the total dues paid in amount to Seventy-Five Dollars and [illegible] so apportioned aggregate the matured value of One Hundred Dollars [illegible]

Shares represented by this certificate are subject to "Conditions" on reverse hereof and are transferable only on the books of the association by the holder in person or by attorney upon surrender of this certificate, properly endorsed.

In Witness Whereof, the association has caused this certificate to be signed by its duly authorized officers 4 day of March A. D. 19 47

_____ President

_____ Secretary

Date Closed	Date Opened	Class	Shares	Series	BOOK NO.

LE COPY (D)

NOV 18 1972

No. 72-442

In the

Supreme Court of the United States

OCTOBER TERM, 1972

J. J. LOWENTHAL, ET AL., A CLASS OF INTERVENING DEFENDANTS,

Petitioners,

v.

ALEXANDER TCHEREPNIN, ET AL., AND THE CLASS FOR WHOM THEY ARE THE NAMED PLAINTIFFS,

Respondents.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1972

No. 72-442

J. J. LOWENTHAL, ET AL., A CLASS OF INTERVENING DEFENDANTS,

Petitioners,

v.

ALEXANDER TCHEREPNIN, ET AL., AND THE CLASS FOR WHOM THEY ARE THE NAMED PLAINTIFFS,

Respondents.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

STATEMENT OF THE CASE

The action below to which the petition for a writ of certiorari relates was brought on July 24, 1964 pursuant to Sections 10(b) and 29(b) of the Securities Exchange Act of 1934 (15 U.S.C.A. §§78j(b) and 78cc(b)) and Rule 10b-5 promulgated thereunder (17 C.F.R. 240, 10b-5), (hereinafter the "1934 Act"). Respondents, investors in capital shares of City Savings Association (hereinafter CSA), sued on their own behalf and as a class action

on behalf of over 5,000 investors similarly situated who purchased such shares between July 9, 1959 and June 26, 1964. The action sought rescission of their purchases and recovery of the purchase prices paid by them for their shares of CSA which Respondents alleged those investors had been induced to purchase by materially false and misleading statements, and omissions to state material facts, in violation of anti-fraud provisions of the 1934 Act (A. 10-24).[1] included as defendants were CSA, certain of its officers and certain officials of the State of Illinois.

Respondents and their class are defined by order entered by the District Court pursuant to Fed. Rules Civ. Proc., rule 23(c), 28 U.S.C.A. as depositors in CSA who first opened their accounts on or after July 9, 1959. Petitioners here are a class of intervening defendants defined as depositors in CSA who opened any account there prior to July 9, 1959. Petitioners' class consists largely of those persons originally represented by the 100-Cents-on-the-Dollar Committee which earlier in this case was permitted to intervene only as a party-defendant (A. 28, 29). They answered Respondents' complaint by denying the commission of frauds alleged therein and, together with the named defendants in the complaints, sought dismissal of Respondents' action on grounds of lack of federal jurisdiction. That position was rejected by this Court at the threshold of this action *sub nom.*, *Tcherepnin* v. *Knight*, 389 U.S. 332 (1967).

The present petition for a writ of certiorari is directed to the decision below affirming the District Court's judg-

[1] This Court in *Tcherepnin* v. *Knight*, 389 U.S. 332 (1967) held Respondents' investments to be securities within the meaning of Section 3(a)(100) of the 1934 Act.

ment in Respondents' favor. That court found specifically that only Respondents and their class had properly pleaded a claim under the Federal Securities laws and that they, as persons who purchased CSA securities for the first time after July 9, 1959, had been defrauded in violation of the anti-fraud provisions of the 1934 Act (A. 46-48.)[2] The fraud was found to have arisen by reason of certain fraudulent misrepresentations, misstatements, and omissions to state material facts in connection with the purchase by Respondents and their class of CSA securities, all those frauds occurring after July 9, 1959. (A. 47, 48). As defrauded purchasers, Respondents and their class were granted rescission of their purchase transactions pursuant to Section 29(b) of the 1934 Act (15 U.S.C.A. §78cc(b)). (A. 48, 49). As a result of this rescission, Respondents and their class became judgment creditors of CSA and thus entitled to priority in the distribution of the proceeds of liquidation of CSA by its Receivers, before its remaining depositors who continue as shareholders rather than creditors (A. 48, 49).

The appeal of that order to the court below was unique in that CSA and the other defendants charged with fraud in the complaint did not appeal. Further, the contentions made in the court below and here by Petitioners disclose that they too do not in any meaningful way contest the District Court's Finding of Facts as to the actual frauds committed on Respondents and their class as alleged in the complaint. Instead, Petitioners again attempt to argue, although they have never so pleaded, that they too were

[2] In referring to the record before this Court, Respondents follow the same procedure described by Petitioners in the footnote appearing at page 11 of their petition. Further, references to the petition for a writ of certiorari will be Ptn., p. ——.

defrauded, that there is but one class of depositors-shareholders and hence that the claims of Respondents and their class should not be preferred (Ptn., pp. 18, 24). As hereinafter shown, that argument is without enough substance to warrant the granting of the petition for certiorari.

Pertinent History of City Savings Association.

CSA was chartered originally by the State of Illinois on February 28, 1908 under a different name. In 1943, it adopted its present name.

On April 25, 1957 the Auditor of Public Accounts of the State of Illinois took custody of CSA and suspended payments to depositors.

Pursuant to a decree entered by the Circuit Court of Cook County, Illinois on December 6, 1957, custody of CSA was restored to its officers and directors on December 14, 1957. It was reopened to the public on December 19, 1957 but on a limited withdrawal rotation basis as to its then existent accounts on which basis it continued until it was again closed by State seizure in June, 1964.

On February 3, 1959, the Circuit Court of Cook County, Illinois entered a final decree adopting the findings and conclusions of the December 6, 1957 decree and terminating jurisdiction of that court over CSA, including the requirement of periodic reports to that court.

On January 22, 1960 the Supreme Court of Illinois affirmed the decree returning custody of CSA to its management (*Mensik* v. *Smith*, 18 Ill.2d 572, (1960)).

On June 26, 1964, the Director of Financial Institutions of the State of Illinois took custody of CSA pursuant to Section 7-8 of the Illinois Savings and Loan Act (S.H.A., Ch. 32, §848) (hereinafter "the Illinois Act") once again.

On June 30, 1964, CSA was closed by the Director of Financial Institutions.

From June 26, 1964 to September 11, 1964, CSA was in the custody of the State of Illinois, acting through the Director.

From September 11, 1964 to September 19, 1968, CSA was in the custody of three liquidators under a plan of so-called voluntary liquidation purportedly adopted under Article 9-1 *et seq.* of the Illinois Act (S.H.A., Ch. 32, §901 *et seq.*).

On September 7, 1968, two federal receivers were appointed by the District Court, who on September 19, 1968 took custody of CSA and have since managed its assets.

The Categories of Withdrawable Capital Shares of City Savings Association and Amounts Therein at Pertinent Times.

CSA had established seven categories or types of withdrawable capital share accounts, four of which were in being long prior to 1959 pursuant to express authorization by Section 4-2 of the Illinois Act (S.H.A., Ch. 32, §762), and three of which were established after July 9, 1959. The pre-July 9, 1959 share accounts were: (1) Optional Shares; (2) Paid-Up Shares; (3) Pre-Paid Shares; and (4) Installment Serial Shares.

The post-July 9, 1959 accounts were: (5) Christmas Club; (6) Investment Shares—Investment Plan; and (7) Investment Shares—Thrift Plan.

With insignificant dollar-amount variations, the first four categories are capital share accounts actually opened by Petitioners *before* July 9, 1959.

The sixth category, Investment Shares—Investment Plan, represents accounts opened by Petitioners long prior to July 9, 1959 but thereafter converted by them into this category, without parting with any new money.

Virtually all accounts first opened after July 9, 1959 and therefore the accounts of Respondents and their class are in the seventh category, Investment Shares—Thrift Plan.

The Distinction Between the Two Classes of CSA Depositors Involved in This Petition (Petitioners and Respondents).

Almost immediately after CSA's custody was restored to its officers and directors by the decree of the Circuit Court of Cook County, Illinois entered on December 6, 1957, CSA, by resolution of its board of directors, imposed limitations on the amounts which its depositors could withdraw within any specified period and placed all its then depositors (Petitioners here) on a rotation withdrawal system. (CSA minutes of December 14, 1957.)[1] In so doing, CSA acted under the provisions of Section 4-13(b) of the Illinois Act (S.H.A., Ch. 32, §773(b)), providing that "if the association has insufficient funds in the treasury and from current receipts to pay all matured accounts and applications for withdrawal, within thirty days after such accounts mature or payment is requested, then the board of directors shall provide by resolution" for the operation of the association on a restricted withdrawal and rotation basis.

The resolution of December 14, 1957 also directed CSA's officers to immediately advise its then shareholders (Pe-

[1] These minutes and others hereinafter referred to were before the court below as part of the record on appeal.

titioners) in writing of these restrictions. On the date of this resolution and continuously thereafter until July 9, 1959, CSA had only the four categories of accounts hereinbefore described, all subject to the restrictions on withdrawals and required to be on a rotation basis. They included all then deposits of Petitioners.

From December 14, 1957 until its seizure in June 1964, CSA continued to operate under the withdrawal restrictions of Section 4-13(b) of the Illinois Act as to these Petitioners' share-accounts and from time to time CSA provided for notice to that effect to Petitioners (CSA minutes of December 14, 1957, May 6, 1958, July 1, 1958, December 16, 1958, January 27, 1959, February 17, 1959, June 19, 1959). During that period and thereafter to June 30, 1964, Petitioners were limited to withdrawals not to exceed $200 an account and then only eleven to fourteen months apart under the rotation system (CSA minutes of July 29, 1958, September 2, 1958, September 30, 1958, December 2, 1958, January 6, 1959, January 27, 1959, February 17, 1959, March 31, 1959).

On July 9, 1959, Section 4-13(h) (S.H.A., Ch. 32, §773(h)) of the Illinois Act became effective until its repeal on July 23, 1965. It provided:

> "(h) An association while operating under this Section [Sec. 4-13(b)] may accept additional withdrawable capital from its present shareholders as well as accept new withdrawable capital accounts and such withdrawable capital accounts shall not be subject to the provisions of subsection (b) of this section but shall be subject to withdrawal at will so long as the association is operating under the provisions of subsection (b) of this section."

Shortly thereafter CSA established the three new forms of accounts: Investment Shares—Investment Plan; Invest-

ment Shares—Thrift Plan; and Christmas Club, which under Section 4-13(h) could not be subject to the restrictions of Section 4-13(b). Virtually all accounts opened by Respondents and their class were Investment Shares—Thrift Plan accounts.

Among the most important frauds charged by Respondents and found by the trial court was the omission of CSA to advise them as newcomers to CSA at the time they opened new deposit accounts or made further deposits therein of the fact that CSA was in tight financial straits as to pre-July 9, 1959 depositors (Petitioners) and was operating under Section 4-13(b) as to those accounts (A. 47). That material non-disclosure to new investors (Respondents) was held to be a violation of the anti-fraud provisions of the 1934 Act (A. 48).

Pursuant to Fed. Rules Civ. Proc. rule 23(c), 28 U.S.C.A., the trial court defined and separated the classes here between (a) those who first opened accounts on or after July 9, 1959 (Respondents and their class) and (b) those who opened any account prior to that date (Petitioners) (A. 46). This division was inevitable and incapable because the enactment of Section 4-13(h), effective on July 9, 1959, permitted new types of unrestricted accounts to be opened in CSA by new depositors. Those new depositors had no knowledge of the prior restrictions on pre-July 9, 1959 accounts and no disclosure of this was made to them. Under these circumstances, the District Court quite justifiably held that the pre-July 9, 1959 depositors (Petitioners) constituted a defendant class having an adverse interest to Respondents' class (A. 5).

REASONS FOR DENYING THE WRIT OF CERTIORARI

The concern of this Court over its ever-increasing caseload and the continuous flow of petitions for certiorari is too well known to require discussion. As it is, that load continues to increase because, among other reasons, there are petitions for writs of certiorari which do meet the standards of Rule 19 of this Court setting forth the character of reasons which will be considered here in determining whether to grant the writ. This petition is not one of them.

Here, Petitioners have made no effort whatsoever to comply with Rule 19. Instead of directing their petition to an exposition of why the decision below involves any of the reasons set forth in that Rule for consideration as to whether to grant the writ, Petitioners have presented here nothing more than a jerry-built reargument of the same matters argued by them on the merits in the court below and there rejected. In making that presentation here, Peittioners have not even gone to the trouble of making changes necessary to indicate that the argument is addressed to this Court and not the court below. (See, for example, the headnote to Point I of their Argument.) Their entire discussion is based upon alleged errors in the trial court and there is not a single word in their argument, not even a critical word, dealing with the opinion below holding that there was no such error and affirming the trial court.[4]

---

[4] The court below did modify the trial court's judgment by enlarging Respondents' class in certain minor respects. 461 F.2d at 554. This modification was suggested by Respondents in their brief filed in the appeal. The modification is not relevant to the question now before this Court.

In short, the petition is in no way responsive to the decision below as required by Rule 19. Under these circumstances, it appears that Petitioners' failures in this respect calls for denial of the petition almost out-of-hand. Nevertheless, out of an abundance of caution, Respondents, as succinctly as possible, consider the matters briefly referred to by Petitioners on the one page of the petition headed "Reasons For Granting The Writ" (Pta., p. 14).

ARGUMENT

I.

THE COURT BELOW DID NOT CONSTRUE THE DECISION OF THIS COURT IN TCHEREPNIN v. KNIGHT, 389 U.S. 332 (1967) SO AS TO CREATE AN INEQUITABLE PREFERENCE IN THE ASSETS OF CITY SAVINGS ASSOCIATION.

Petitioners claim that the court below has construed this Court's threshold decision in this case *sub nom. Tcherepnin* v. *Knight,* 389 U.S. 332 (1967) so as to create "an inequitable preference in the assets of a defunct savings and loan association for about one-half of the depositors" (Ptn., p. 14). This bald assertion is left to stand by itself and there is no argument made thereafter in its support, undoubtedly for the reason that the opinion below provides absolutely no basis for such argument.

As a matter of fact, the only reference in the body of the opinion below to *Tcherepnin* v. *Knight* is in connection with the comment by the court below by way of *dicta* as to the jurisdictional grounds for Respondents' action under the 1934 Act as found by this Court, 461 F. 2d at 546, 547. That jurisdiction was held in *Knight* to exist because under the circumstances of this case a withdrawable capital share in an Illinois savings and loan association is a "security" within the meaning of the 1934 Act.

The court below by setting forth a quotation from this Court's opinion in *Knight,* 461 F.2d at 547, indicated its express understanding that *Knight* involved only the jurisdictional question and that any questions relating to priority of claims and superiority of rights as between

classes of CSA depositors were irrelevant to the *Knight* decision (See *Knight,* 389 U.S. at 346). There is just nothing in the decision below which indicates any departure from that understanding by the court below.

Because, as pointed out above, Petitioners are not responsive to the reasoning of the court below in support of its decision, it is difficult to meet arguments which are not made. Respondents point out, however, that to the extent Petitioners' point is comprehensible at all, they are contending that because they were still shareholders in CSA (under the decision in *Knight*) when the frauds alleged in Respondents' complaint were committed, Petitioners likewise became entitled to the same rights as Respondents. This is a complete *non-sequitur*. (It was referred to in Respondents' brief in the court below as the "me too" argument.)

Any such contention of Petitioners would have no merit for the following reasons:

1. Respondents' complaint alleging violation of Section 10(b) of the 1934 Act and Rule 10b-5 promulgated thereunder was the only complaint ever filed in the trial court. Petitioners, as intervening defendants, resisted the complaint on the merits and denied the fraud allegations therein set forth. Petitioners never filed any appropriate pleading in this proceeding alleging any fraud on them. At the trial, they conceded the frauds alleged by Respondents.

2. Section 10(b) of the 1934 Act and Rule 10b-5 by their express language and court interpretation protect investors only against frauds in connection with "the purchase or sale" of a security. That protection does not extend to frauds subsequent to any purchase or sale and not connected therewith.

3. Petitioners invested their money in CSA long prior to the commission of the frauds alleged and proved by Respondents. Those frauds then had no relation back to Petitioners' purchase of CSA's shares. Petitioners thus had no cause of action under the 1934 Act. On the other hand, the proof at the trial established that the frauds alleged in the complaint directly caused Respondents' purchases of CSA's securities and hence were actionable under the 1934 Act.

4. Petitioners were not without opportunity to sue in the State courts for any post-purchase frauds arising out of waste, mismanagement, breach of fiduciary duty and the like. But they brought no such action.

The decision below both expressly and implicitly, 461 F.2d at 442, relies on these factors as a *ratio decidendi*. None of those factors are discussed by Petitioners.

II.

PETITIONERS MAKE NO SHOWING THAT THE COURT BELOW DEPARTED FROM THE ACCEPTED AND USUAL COURSE OF JUDICIAL PROCEEDINGS IN HOLDING THAT PETITIONERS WERE ACCORDED DUE PROCESS IN THE TRIAL COURT.

Petitioners complain that they were excluded by the District Court from participation in the liquidation of CSA's assets without a trial and without "the support of evidence" (Petn., p. 14). They state that by its affirmance of this conduct the Court below has departed from the accepted and usual course of judicial proceedings.

In support of this proposition Petitioners advance the same argument made below critical of the trial court's reliance on the Manual for Complex and Multi-District Litigation and they repeat their assertion that the trial

court by an "indefinite order" admitted evidence in wholesale fashion without foundation or opportunity for them to object (Ptn., p. 16).

The court below decided this point adversely to Petitioners, held they had been accorded due process, and pointed out, among other things, that the procedure utilized by the trial court was proper under the circumstances here and that petitioners had been free under that procedure to offer evidence and to argue the relevance or probative value of any of the evidence admitted. 461 F.2d at 548, 549.

The holding of the court below was based on an examination of the record in the trial court and it referred in detail to those proceedings. Petitioners do not here attempt to meet the decision in this or any other respect. Hence their contention as to the departure of the court below from "accepted and usual course of judicial proceedings" is without merit. This becomes even more evident when it is noted that in its decision, the court below stated, 461 F. 2d at 549:

> "The district court thus outlined for the parties how it intended to handle the case. The transcript shows no response to the court's query by counsel for the pre-July 9, 1959 depositors. *Those investors made no objection to this form of trial procedure. In response to questioning during oral argument, their counsel told this court that they had never offered any evidence nor had they been denied the right to offer evidence. Counsel further informed us that the district court had been willing to review any pertinent evidence that the parties brought to its attention.*" (Emphasis added.)

Petitioners' failure here to even comment on those admissions by them to the court below during the oral argument there effectively demonstrates the untenability (and unworthiness) of their argument here.

III.

PETITIONERS' CLAIMS BASED ON THEIR SIGNING OF CSA PERMANENT PROXIES AFFORDS THEM NO RIGHT TO RELIEF UNDER THE SECURITIES EXCHANGE ACT OF 1934 NOR DO THOSE CLAIMS CONSTITUTE GROUNDS FOR GRANTING THE WRIT.

In their repetition here of the same arguments made on the merits in the court below, Petitioners again argue that they were defrauded by being induced to sign permanent proxies which were utilized by CSA's defendant officers to keep themselves in office and thus perpetuate their power and ability to perform the frauds established in this case (Ptn., pp. 20, 23, 25).

In deciding this contention adversely to Petitioners, the court below stated, 461 F. 2d at 550:

> "Underlying the second argument of the pre-July 9, 1959 depositors is the premise that the use by the named defendants of the permanent proxies to 'perpetuate [their] power and ability to perform frauds, misrepresentations and concealments' is covered by Section 10(b) and Rule 10b-5. Those provisions involve the purchase or sale of a security. The solicitation of proxies or the giving of them or the failure to revoke a proxy is not by itself the purchase or sale of a security. Further, Section 14(a) of the Securities Exchange Act of 1934 and Rule 14(a) thereunder regulating proxy solicitation apply only to securities registered under Section 12 of the Act. Withdrawable shares such as those in CSA are exempt from such registration under Section 12(g)(2)(C) of the Act.

> The intervening defendants-appellants' reliance on Mills v. Electric Auto-Lite Co., 396 U.S. 375, 90 S. Ct. 616, 24 L. Ed. 2d 593 (1970) is, therefore, misplaced."

The petition in no way responds to this impeccable holding and attempts no showing as to why this point would fall within the ambit of Rule 19 of this Court.

IV.

PETITIONERS' RELIANCE ON J. I. CASE v. BORAK, 377 U.S. 426 (1964) AND MILLS v. ELECTRIC AUTO-LITE CO., 396 U.S. 375 (1970) IS MISPLACED. NEITHER OF THOSE CASES IS APPOSITE HERE.

Petitioners state that "The District Court has failed to follow two decisions which the Intervening Defendants believe compel a holding that all defrauded depositor-shareholders had void contracts under 15 U.S.C., Section 78cc(b) and should be treated equally under the law." (Ptn., p. 26)[5] The decisions referred to are *J. I. Case* v. *Borak*, 377 U.S. 426 (1964) and *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375 (1970).

Each of those cases dealt with alleged violations of Section 14(a) of the 1934 Act and not Section 10(b) of that Act, the section here involved. They do not stand for the proposition for which they are cited. They are inapposite here and the court below so recognized. (461 F.2d at 550.) Petitioners do not comment on this at all.

To the extent that Petitioner urge that *Borak* holds that federal courts may fashion appropriate remedies where

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[5] This reference to the "District Court" again emphasizes Petitioners' failure to find anything to attack in the decision in the court below and again evidences the jerry-built nature of the petition.

federal rights are invaded in violation of a federal statute, Respondents point out that without such violation, obviously no remedy may be so fashioned. Petitioners have never been able to show any violation of their rights under Section 10(b) of the 1934 Act or that they even pleaded such a violation. That Section with Rule 10b-5 promulgated thereunder, is the only federal statute here involved.

V.

PETITIONERS' ATTACK ON THE SUFFICIENCY OF THE COMPLAINT AND THE TRIAL COURT'S JURISDICTION TO ENTER JUDGMENT IN THIS CAUSE IS MERITLESS AND DOES NOT DESERVE FURTHER ATTENTION FROM THIS COURT.

In what is patently a dying grasp at a straw, Petitioners at this last stage of this case argue for the first time that Respondents' complaint did not state a cause of action and that therefore the District Court was without jurisdiction to enter any judgment (Ptn., p. 31).

This absurd stance for granting the writ is based upon the contention that Respondents failed to plead in their rescission action an offer of restitution of the T.V. sets, typewriters, radios, etc. which Petitioners claim Respondents received as "premiums" when they purchased securities in CSA (Ptn., pp. 30, 31). Petitioners urge this Court to decide this question. They do not say why or how this picayune question, even if it were meritorious is important enough to warrant the attention of this Court or how it falls within Rule 19, or why it was never raised below.

Apart from pointing out that Petitioners have never raised this question below and in any event, would have had no standing to do so, Respondents refrain from further answer.

CONCLUSION

For the foregoing reasons, Respondents respectfully submit that the petition for a writ of certiorari be denied.

Respectfully submitted,

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